S. Hrg. 99-712

THE ANTITRUST IMPROVEMENTS ACT OF 1986
(Illinois Brick)

HEARING

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2481

A BILL TO AMEND THE CLAYTON ACT REGARDING ANTITRUST ENFORCEMENT, AND FOR OTHER PURPOSES

JUNE 3, 1986

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THE ANTITRUST IMPROVEMENTS ACT OF 1986—S. 2481

TUESDAY, JUNE 3, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Hatch, Metzenbaum, McConnell, and Specter.

Staff present: Kenneth Starling, chief antitrust counsel; Dee Benson, counsel; Vic Maddox, counsel; Eddie Correia, minority counsel; and Neal Manne, counsel.

OPENING STATEMENT OF SENATOR ORRIN G. HATCH

Senator HATCH [acting chairman]. I would like to call this committee meeting to order. Several times over the past 9 years Congress has debated legislation to reverse the *Illinois Brick* antitrust enforcement decision.

Just a few months ago, for instance, the Senate rejected by an overwhelming margin an amendment to the farm bill which would have reversed the *Illinois Brick* rule for agricultural products

As is well known, the *Illinois Brick* case confirmed the principle that only direct purchasers may bring suit for antitrust violations of price-fixing, bid-rigging, or similar offenses under the Clayton Act.

The *Hanover Shoe* case had reached that same conclusion years before regarding sellers rather than purchasers of goods, holding that an antitrust seller could not escape liability by showing that the plaintiff purchasers had passed on the charge.

The reasons for the Supreme Court's consistent position on this issue are certainly worthy of reconsideration in today's hearing. As the Supreme Court has noted, an attempt to compensate every participant in a lengthy distribution chain would become so complex and so complicated that the task of ascertaining antitrust liability "would normally prove insurmountable."

Imagine an alleged overcharging scheme in one of the elements of the steel smelting process. Every consumer of the product containing steel, such as automobiles, and every business involved in manufacturing or distributing a product made with steel—in short, nearly every American could claim to have been illegally overcharged to some degree.

The burden of allocating damages amongst thousands of plaintiffs competing for a diminishing share of the pot would be so great that only lawyers litigating these issues would profit.

In addition to a nearly limitless number of plaintiffs and lawyers, the courts would also face the unwieldy task of deciding how complex, interrelated economic factors affect prices in different industries

Meantime, the offending party could sit back and watch the overburdened court struggle for years to resolve legal scraps amongst an ever-growing list of indirect purchasers.

In the second place, abandoning the *Illinois Brick* rule could actually reduce deterrence. Suits for treble damages brought by direct purchasers now act as an effective deterrent to antitrust violations.

Under this bill, damages would be spread thin and the costs of sorting out the rights of countless litigants would increase. This would, in turn, discourage direct purchasers from embarking on an impossible quest.

Since direct purchasers are the parties with the best evidence of antitrust injury, they are, according to the courts, the best deterrent, and I think according to almost everybody else. It would be unwise to erect barriers to direct purchaser suits.

Finally, as these suits would approach the unmanageable task of sorting out parties and the supposed effects of various economic forces, the risks of inconsistent judgments and multiple liability would mount

A careful consideration of this issue in the past has led me to the conclusion that the tangle in the courts created by a reversal of *Illinois Brick* would benefit no one. While it may sound admirable to seek to compensate every potential indirect purchaser in an overpricing scheme, we must examine the costs of reaching that particular goal.

Those costs include discouraging meritorious suits, reducing deterrence of antitrust violators as the certainty of recovery diminishes, and imposing inconceivable evidenciary and procedural burdens on our already over-taxed courts. In this light, the goal becomes illusory.

One thing I have learned from dealing with this issue over the years is that it is certainly complex. We will undoubtedly get tangled just trying to untangle all the issues in this hearing today—and it is a brief hearing at that—I have also learned, however, that my colleague from Ohio, Senator Metzenbaum, of course, is a master at tangling. Some say that I am, also, so we will be well served to get this process underway and see if we can tangle or untangle based upon our understanding of the antitrust laws.

Before the testimony begins I wish to place a statement of Senator Metzenbaum and a copy of S. 2481 in the record.

[The aforementioned follows:]

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

The committee today will hear testimony on one of the greatest inequities in the antitrust laws—the inability of consumers to be compensated for injury if they do not deal directly with the antitrust violators. Since 1977, the Congress has been petitioned by every State in the Union to change this rule. Once again, the Judiciary

Committee will consider legislation to overturn it and provide some fairness to the average American who pays higher prices from price-fixing.

The fact is that under the law today, consumers cannot sue for damages if the automobile manufacturers fixed prices for new cars. The only parties who could sue are the dealers. If the dealers decided not to sue because of their close relationship to the manufacturer, or because the dealers themselves benefited from the conspiracy, the manufacturers pay nothing. If the dealers do decide to sue, they recover all the damages, even if they had been able to pass on the entire overcharge to their customers.

Today, if all the food manufacturers in this country decided that they would raise the price of certain food products, consumers could do nothing. The same goes for televison sets, clothing and drugs. Today, the States buy 90 percent of their supplies from persons other than the manufacturer. If the manufacturer is engaged in a price-fixing conspiracy, the States are literally helpless. If the United State buys from a defense contractor, and the subcontractors have conspired to fix prices, driving up the final cost by millions of dollars, the United States cannot sue for damages. This illogical and inequitable result of the law must be changed.

The bill I have introduced, cosponsored by Senators Gorton, Kennedy, Bingaman, Stafford, and Rudman, would partially overturn the *Illinois Brick* decision. I have received a number of helpful suggestions and comments which have been incorporated into a revised version of the bill which will be considered by the Judiciary Committee on June 5. The bill would allow State attorneys general to sue on behalf of their citizens and for injuries to the State itself. The U.S. Attorney General would be able to sue for injuries to the United States in its purchases. Finally, the bill would allow suits by State attorneys general on behalf of sellers of agricultural products.

The bill is carefully drafted to avoid forcing the defendant to pay twice for the same injury. It also includes procedures to encourage the parties to consolidate their suits so that the court can more easily allocate damages between the claimants. The opponents of overturning the *Illinois Brick* decision say it is too complicated to allow indirect purchasers to sue. The fact is that may issues in antitrust litigation are complicated but we accept complexity as a price for fairness. Simplicity has to be balanced against the gross unfairness of the current law. Prior to the *Illinois Brick* decision, the State attorneys general were able to recover tens of millions of dollars for consumers. In one case alone, involving tetracycline, the States recovered $100 million. These cases showed that indirect purchase claims were manageable and that they provided substantial benefits to consumers.

The current law is also unfair to farmers and ranchers. They often sell at auctions or in other ways where prices are set by supply and demand. But down the line, the demand for their products can be affected by price-fixing. By denying them the right to sue, the current law shields the wrongdoer at the expense of the innocent party.

The Judiciary Committee recently reported favorably a bill drastically reducing the penalties for antitrust violations. Frankly, the committee saw fit to give a break to criminal price-fixers. This bill provides the opportunity to give consumers a break, too. I hope my colleagues support it.

II

99TH CONGRESS
2D SESSION

S. 2481

To amend the Clayton Act regarding antitrust enforcement, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MAY 21 (legislative day, MAY 19), 1986

Mr. METZENBAUM (for himself, Mr. GORTON, Mr. KENNEDY, Mr. BINGAMAN, and Mr. STAFFORD) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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A BILL

To amend the Clayton Act regarding antitrust enforcement, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Antitrust Improvement Act of 1986".

SEC. 2. Section 4C(a)(1) of the Clayton Act is amended by adding between the first and second sentences thereof the following: "In any civil action alleging a contract, combination, or conspiracy to fix, maintain, or stabilize prices, a claim for damages may be based on indirect purchases. In the case of a civil action on behalf of producers of agricultural products, a claim for damages may be based on indirect sales in addition to any other claim permitted.".

SEC. 3. Section 4C of the Clayton Act is amended by adding at the end thereof the following:

"(e)(1)(A) If a State attorney general asserts a claim for damages based on indirect purchases or sales pursuant to subsection (a)(1), the defendant shall be entitled to allege, as a partial or complete defense to a claim by a direct purchaser or seller based on the same or substantially the same alleged conduct, that some or all of what would otherwise constitute the direct purchaser's or seller's damages were passed on by the direct purchaser or seller to persons on whose behalf the claim for damages from indirect purchases or sales was brought.

"(B) In the case of a claim based on indirect purchases or sales, the award shall be treble the amount of the overcharge or underpayment shown by the indirect purchaser or seller to be properly allocable to it (in addition to costs and attorneys' fees): *Provided*, That in the case where no claim by a direct purchaser or seller is pending, the defendant shall have the burden of establishing that the total overcharge or underpayment was not passed on to the indirect purchaser or seller.

"(C) The amount awarded to a plaintiff for a claim based on direct or indirect purchases or sales shall not duplicate amounts previously awarded to a direct or indirect purchaser or seller for the same overcharge or underpayment based on proof in fact of such injury.

"(2)(A) Any person entitled to maintain an action pursuant to subsection (a)(1), alleging injury from indirect purchases or sales, may intervene in any action under section 4 alleging injury from direct purchases or sales based on the same or substantially the same alleged conduct, if a request for such intervention is made within six months after the date of the filing of the initial action. The failure to request intervention in a pending action by any person alleging injury from indirect purchases or sales, within such time, shall constitute a bar to a claim by such person for injury from indirect purchases or sales based on the same or substantially the same alleged conduct.

"(B) Any person initiating an action under section 4 may intervene in any action under subsection (a)(1) which alleges injury from indirect purchases or sales based on the same or substantially the same alleged conduct.

"(C) Upon a request made by the defendant, the court shall order the consolidation of any pending actions pursuant to subsection (a)(1) alleging injury from indirect purchases or sales and any other action under section 4 based on the same or substantially the same alleged contract, combination, or conspiracy.

"(3) Upon the initiation of any action pursuant to subsection (a)(1) alleging injury from indirect purchases or sales, the State attorney general shall provide reasonable public notice of the allegations of the suit and, to the extent possible, a general description of any direct purchasers who may be entitled to maintain an action under section 4.

"(4) Upon the initiation of any action pursuant to section 4 alleging a contract, combination, or conspiracy to fix, maintain, or stabilize prices, the plaintiff shall provide reasonable notice of the allegations of the suit to the State attorneys general.".

Senator HATCH. We will call as our first witness Senator Bingaman, from New Mexico, who will introduce our first witness, Charles Brown, who is the attorney general of West Virginia, and Priscilla Budeiri, from the Public Citizen in Washington, DC. We would like to call these people to the witness table at this time.

Senator Bingaman, we will turn the time over to you. We are happy to have you at the committee. We are happy to welcome all the witnesses here today, and look forward to hearing from you.

STATEMENT OF A PANEL CONSISTING OF: THE HON. JEFF BINGAMAN, A U.S. SENATOR FROM THE STATE OF NEW MEXICO; CHARLES B. BROWN, ATTORNEY GENERAL, STATE OF WEST VIRGINIA, CHARLESTON, WV, AND VICE CHAIRMAN, ANTITRUST COMMITTEE, NATIONAL ASSOCIATION OF ATTORNEYS GENERAL; AND PRISCILLA BUDEIRI, STAFF ATTORNEY, PUBLIC CITIZEN'S CONGRESS WATCH, WASHINGTON, DC, ON BEHALF OF THE CONSUMERS UNION AND THE CONSUMER FEDERATION OF AMERICA

Senator BINGAMAN. Thank you very much, Mr. Chairman. Let me just indicate that I am here to testify today in support of S. 2481, the Consumer Remedies Improvement Act of 1986, which was introduced by Senator Metzenbaum, cosponsored by Senators Gorton, Kennedy, Stafford, and myself.

I want to thank you, Mr. Chairman, for holding the hearing today and, of course, commend Senator Metzenbaum for the introduction of the legislation.

I would like to ask that my full statement be included in the record as if read, and I will save the committee's time and not go through the entire statement.

Senator HATCH. Without objection, we will put the statement in the record.

Senator BINGAMAN. As a former attorney general in my home State of New Mexico, I am familiar with the need to enact legislation like this, specifically to provide responsible public officials with the means to preserve and protect the interests of taxpayers in their State from the needless waste of millions of dollars in the form of inflated prices which result from price-fixing or bid-rigging in the procurement process.

Mr. Chairman, before I turn it over to Attorney General Brown from West Virginia, let me just recite a specific instance that I encountered as Attorney General of New Mexico that first got me interested in this issue.

We had a case in the Federal court in Albuquerque where four companies, manufacturers of concrete or cement, were convicted of price-fixing in criminal proceedings. As Attorney General, since most of the concrete or cement that they had fixed the price on had been sold for projects the State was involved in, I, of course, tried to pursue individual damages against them and make recovery for the State.

What I encountered was a situation in which about 95 percent of the cement on which the price had been fixed was sold not to the State directly, but to contractors who were hired by the State to work on highways and bridges and various types of construction.

So our problem was that the *Illinois Brick* decision prevented the State of New Mexico from suing those manufacturers of cement, whereas the contractors would have had a right to sue.

It seemed to me at the time an inequitable result, and I think this legislation would correct that. I think that there should be a remedy even for indirect purchasers against those who engage in price-fixing or bid-rigging.

So, for that reason, I support the legislation and am proud to cosponsor it.

Let me defer at this point to Charles Brown, who is the attorney general of West Virginia, who I understand is testifying today on behalf of the National Association of Attorneys General. He is the vice chairman of the antitrust division of that association and he has extensive experience in this particular field of the law.

So I will close, Mr. Chairman, and thank you again for the opportunity to be here today. Thank you.

[Prepared statement follows:]

STATEMENT OF SENATOR JEFF BINGAMAN

MR. CHAIRMAN, I AM PLEASED TO HAVE THIS OPPORTUNITY TO APPEAR IN SUPPORT OF S. 2481, THE CONSUMER REMEDIES IMPROVEMENT ACT OF 1986. I WANT TO COMMEND SENATOR METZENBAUM FOR HIS LEADERSHIP IN INTRODUCING THIS LEGISLATION. I ALSO WANT TO COMMEND SENATOR THURMOND, THE DISTINGUISHED CHAIRMAN OF THE JUDICIARY COMMITTEE FOR HOLDING THIS HEARING TODAY.

MR. CHAIRMAN, AS ATTORNEY GENERAL OF THE STATE OF NEW MEXICO, I ADVOCATED SIMILAR LEGISLATION, AND I AM AS STAUNCH IN MY SUPPORT FOR THIS MEASURE TODAY. S. 2481 PROVIDES RESPONSIBLE PUBLIC OFFICIALS WITH THE MEANS TO PRESERVE AND PROTECT THE INTERESTS OF TAXPAYERS IN THEIR STATES FROM THE NEEDLESS WASTE OF MILLIONS OF DOLLARS IN THE FORM OF INFLATED PRICES AS A RESULT OF PRICE FIXING OR BID RIGGING IN THE PROCUREMENT PROCESS.

IN DECEMBER, 1977, FEDERAL INDICTMENTS WERE ENTERED IN NEW MEXICO AGAINST FOUR MANUFACTURERS OF PRE-STRESSED CONCRETE. THEY WERE CHARGED WITH ILLEGAL ALLOCATION OF CONSUMER TERRITORY IN VIOLATION OF ANTITRUST LAWS. THE MANUFACTURERS ENTERED PLEAS OF NOLO CONTENDERE AND FINES WERE IMPOSED BY THE U.S. DISTRICT COURT.

PRE-STRESSED CONCRETE IS A MATERIAL WHICH IS WIDELY USED IN CONSTRUCTION PROJECTS OF THE STATE OF NEW MEXICO AND ITS LOCAL SUBDIVISIONS. THESE GOVERNMENTAL ENTITIES HAD ENTERED INTO MANY CONTRACTS IN WHICH CONTRACTORS HAD USED THE CONCRETE. SUBSTANTIAL AMOUNTS OF PUBLIC MONIES WERE PAID BY THE STATE TO THESE CONTRACTORS WHO HAD PURCHASED CONCRETE FROM THE INDICTED MANUFACTURERS. THE STATE ITSELF HAD MADE SOME RELATIVELY SMALL PURCHASES OF THE CONCRETE DIRECTLY FROM TWO OF THE MANUFACTURERS. APPROXIMATELY 95% OF ALL PRE-STRESSED CONCRETE USED FOR STATE OF NEW MEXICO JOBS WAS THROUGH INDIRECT PURCHASES FROM THE MANUFACTURERS UNDER CONTRACTS LET BY THE STATE.

GENERALLY, WHEN DEFENDANT-MANUFACTURERS ENTER PLEAS ON A criminal complaint, there would be substantial evidence present to proceed against the antitrust violators for civil damages. However, because of the Supreme Court decision in *Illinois Brick Co. v. Illinois* a few months prior to the Federal indictments and subsequent pleas, this issue was in doubt due to most of the concrete purchases having been made *indirectly* from the manufacturers through contractors. Suit was not filed at that time.

When I became Attorney General for New Mexico in 1979, a suit was filed on behalf of the State of New Mexico against the pre-stressed concrete manufacturers for both the direct *and* indirect purchases of the product by the State. Because of the *Illinois Brick* decision, the issue was whether the State would be successful in recovering for the *indirect* purchases which constituted the substantial amount of monies spent by the State. Two of the smaller manufacturers have settled with the State in the case and approximately $100,000 of tax dollars have been returned to New Mexico. The case is otherwise still pending in the Federal court and the outcome uncertain because of the *Illinois Brick* decision.

The current state of the law does not permit taxpayers to recover tax dollars paid in the form of inflated prices. In 1977, the Supreme Court decided the case of *Illinois Brick v. Illinois*, 431 U.S. 720 (1977). The State of Illinois had sued manufacturers of concrete blocks for price fixing. The blocks had been sold to middlemen who in turn sold them to the State. Illinois sued for injury to itself and not as *parens patriae* on behalf of its citizens. In disallowing the suit, the Supreme Court held that suits under Section 4 of the Clayton Act could be brought only by *direct* purchasers and not by buyers farther down the chain of distribution who were *indirect* purchasers. However, approximately 90% of the purchases made by State and local governments are through middlemen. Costs which are attributable to price fixing are thereby absorbed by taxpayers because the State or local government is an *indirect* purchaser.

By limiting the right to sue to direct purchasers, the *Illinois Brick* decision denies legal rights to citizen-taxpayers who are the parties most likely to be injured. It preserves the right to sue to parties least likely to be injured or least likely to file suit in

ANTITRUST VIOLATIONS. MIDDLEMEN SUCH AS CONTRACTORS ARE RELUCTANT TO PURSUE ACTIONS AGAINST THEIR SUPPLIERS FOR FEAR OF RETALIATION IN FUTURE PURCHASES. AND, BECAUSE THE HIGHER COST HAS BEEN PASSED ON, THE MIDDLEMAN MAY HAVE NO REASON TO SUE FOR HE HAS NOT BEEN FINANCIALLY INJURED. HOWEVER, THE FACT IS THAT THE MIDDLEMAN STILL HAS THE RIGHT TO SUE AND IF HE CHOOSES TO AND IS SUCCESSFUL, ANY RECOVERY RESULTS IN A WINDFALL. THIS IS SIMPLY NOT LOGICAL PUBLIC POLICY.

THE RIGHT TO SUE FOR ANTITRUST VIOLATIONS

S. 2481, THE CONSUMER REMEDIES IMPROVEMENT ACT OF 1986, IS A LIMITED AND RESPONSIBLE APPROACH TO THE ISSUE. TO PROVIDE A REMEDY TO A STATE OR ANY OF ITS POLITICAL SUBDIVISIONS TO RECOUP TAX DOLLARS SPENT THROUGH HIGHER PRICES FOR INDIRECT PURCHASES, THE BILL WOULD ALLOW THE ATTORNEY GENERAL OF A STATE TO SUE ON THEIR BEHALF. FURTHER, THE ACTION COULD BE MAINTAINED REGARDLESS OF WHETHER THE ENTITY HAS PURCHASED INDIRECTLY FROM THE ALLEGED VIOLATOR.

THE BILL CLARIFIES THE LAW AND GRANTS AUTHORITY TO ATTORNEYS GENERAL TO REPRESENT NATURAL PERSONS WHO HAVE BEEN INJURED BY PRICE FIXING OR BID RIGGING. FOR EXAMPLE, IF A MERCHANT SELLS A STOVE AND LATER DISCOVERS THAT THE PRICE WAS FIXED BY MANUFACTURERS, HE OR SHE MAY SUE UNDER THE ANTITRUST LAWS. HOWEVER, IF THE MERCHANT HAS PASSED THE RIGGED PRICE ON TO A CONSUMER, THERE IS NO REMEDY FOR THE CONSUMER BECAUSE HE CANNOT SUE UNDER ILLINOIS BRICK AS AN INDIRECT PURCHASER. COSTS OF LITIGATION CAN BE PROHIBITIVE WHEN CONSIDERED IN TERMS OF THE HIKED PRICE. BY ELIMINATING THIS LOOPHOLE IN THE LAW, CONSUMERS WILL BE RESTORED A LEGITIMATE RIGHT.

SAFEGAURDS TO PROTECT SELLERS FROM UNFAIR OR FRIVOLOUS CLAIMS

IN RESTORING THE RIGHT OF INDIRECT PURCHASES TO BRING SUITS, THERE HAS BEEN CRITICISM THAT DEFENDANTS WOULD BE EXPOSED TO FRIVOLOUS LAWSUITS. THE BILL WOULD NOT PERMIT AN INDIVIDUAL CONSUMER TO BRING ACTION AGAINST THE SELLER THROUGH A PRIVATE ATTORNEY. ONLY THE RESPECTIVE ATTORNEY GENERAL WOULD BE AUTHORIZED TO DO SO. SIMILARLY, THE CITIES

AND COUNTIES MUST BE REPRESENTED BY THE ATTORNEY GENERAL.

AS AN ADDITIONAL SAFEGAURD, THE BILL SPECIFICALLY ALLOWS A DEFENDENT TO PROVE AS A PARTIAL OR COMPLETE DEFENSE TO THE ACTION THAT SOME, OR ALL OF THE POTENTIAL DAMAGES SUFFERED BY THE INJURED PARTY HAVE BEEN PASSED ON TO OTHERS WHO ARE THEMSELVES ENTITLED TO RECOVERY. THIS ASSURES THAT DEFENDANTS WOULD NOT BE EXPOSED TO MULTIPLE LIABILITY ARISING OUT OF ACTIONS BY BOTH A DIRECT PURCHASER AND AN ATTORNEY GENERAL FOR AN INDIRECT PURCHASER. THE APPORTIONMENT OF DAMAGES FOR VIOLATIONS WOULD THUS BE ACCORDING TO ACTUAL LOSS.

BECAUSE ATTORNEYS GENERAL OF THE RESPECTIVE STATES GENERALLY HAVE LIMITED RESOURCES AVAILABLE AND ARE UNDER SCRUTINY OF THEIR STATE LEGISLATURES, IT CAN REASONABLY BE SAID THAT THEY WOULD NOT UNDERTAKE LITIGATION WITHOUT CAREFUL ANALYSIS OF THE CHANCES FOR SUCCESS.

THE ACT WILL NOT COMPLICATE ANTITRUST PROCEEDINGS OR HAVE MUCH EFFECT ON THE WORK LOAD OF THE FEDERAL COURTS

ANTITRUST CASES WOULD BE NO MORE COMPLEX THAN THEY WERE BEFORE THE *ILLINOIS BRICK* DECISION IN 1977. COMPLEXITY IS, IN FACT, REDUCED BY PERMITTING ONLY DIRECT PURCHASERS OR ATTORNEY GENERALS OR THE U.S. ATTORNEY TO BE PARTIES TO A CASE. THE PROPOSED LEGISLATION SEEKS TO ASSURE THAT THE TRULY INJURED ARE THE ONES WHO RECOVER.

BY PROVIDING LIMITED ACCESS TO THE COURTS ONLY TO ATTORNEY GENERALS OR DIRECT PURCHASERS, THE WORK LOAD OF THE FEDERAL COURTS WOULD NOT BE SUBSTANTIALLY INCREASED. THIS LIMITED INITIATION OF PROSECUTION SHOULD DISPEL ANY FEAR THAT THE FLOODGATES OF PRIVATE LITIGATION WOULD BE OPENED WIDE.

S. 2481 CURES THE POTENTIAL PRECLUSION OF CITIZENS TO RECOVER DAMAGES UNDER THE PARENS PATRIAE PROVISION ADOPTED IN THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT OF 1976

IN *HANOVER SHOE, INC. V. UNITED STATES SHOE MACHINERY CORP.*, 392 U.S. 481 (1968), A DIRECT PURCHASER SUED A MANUFACTURER FOR PRICE FIXING. THE MANUFACTURER ARGUED IN

ITS DEFENSE THAT THE DIRECT PURCHASER HAD NOT BEEN INJURED BECAUSE THE ILLEGAL OVERCHARGES HAD BEEN PASSED ON TO THE CUSTOMERS. THE SUPREME COURT REJECTED THIS DEFENSIVE USE OF THE "PASS-ON" THEORY. THE COURT HELD THAT DIRECT PURCHASERS COULD SUE FOR ANTITRUST DAMAGES DESPITE THE FACT THAT THE HIGHER COSTS HAD BEEN PASSED ON.

PRECLUDING CITIZENS, STATES AND LOCAL GOVERNMENTS FROM RECOVERING FOR DAMAGES FROM PRICE FIXERS RESULTS IN WASTE OF TAX DOLLARS IF PURCHASES ARE THROUGH MIDDLEMEN. THE FEDERAL GOVERNMENT ALSO MAKES MANY INDIRECT PURCHASES. CURRENTLY, ANTITRUST VIOLATORS MAY ENRICH THEMSELVES AT THE EXPENSE OF THE PUBLIC TREASURY WITH LITTLE FEAR OF BEING HELD LIABLE FOR DAMAGES. S. 2481 WILL RECTIFY THIS AND CONSERVE TAX DOLLARS WHICH WILL LEAD TO COST EFFICIENT GOVERNMENT.

FAIRNESS TO CONSUMERS AND TAXPAYERS REQUIRES THAT THE RIGHT TO SUE BE RETURNED TO THE TRULY INJURED PARTY IN THE ANTITRUST VIOLATIONS. ULTIMATELY, TAX MONEY IS AT ISSUE AND UNLESS LOCAL GOVERNMENTS CAN FILE ANTITRUST SUITS AGAINST THOSE WHO HAVE GOUGED THEM THRUGH PRICE FIXING OR CONSPIRACY SCHEMES, THE PUBLIC WILL SUFFER.

WE DEVOTE MUCH TIME AND ENERGY IN THIS BODY TO DEVISE MEANS TO ELIMINATE WASTE, FRAUD, AND ABUSE FROM OUR PROGRAMS. THIS IS RIGHT AND PROPER SINCE SUCH ABUSES BLEED THE TREASURY AND SAP THE PUBLIC'S CONFIDENCE IN THEIR GOVERNMENT. THIS BILL PROVIDES RESPONSIBLE STATE AND FEDERAL OFFICIALS WITH MEANS TO OBTAIN REDRESS FROM SUCH ILLEGAL ACTION.

I HOPE THE COMMITTEE WILL ACT FAVORABLE ON THIS BILL. THANK YOU, MR. CHAIRMAN.

Senator HATCH. Thank you, Senator.

It is a tribute to you, Attorney General Brown, to have Senator Bingaman come and introduce you. We look forward to hearing what you have to say.

Attorney General Brown, we will turn to you.

STATEMENT OF HON. CHARLES B. BROWN

Mr. BROWN. Thank you, Senator Bingaman, very much.

Senator Hatch and Senator Metzenbaum, I appreciate you convening this hearing and I want to speak on behalf of Senate bill 2481. It appropriately, I think, is sponsored by three Democrats and three Republicans. I believe Senator Rudman, I have penciled in, anyway, is a sponsor of this as well.

This bill seeks a limited reversal of the *Illinois Brick* decision. I come before you as a lawyer with some experience in antitrust. I am vice chairman of the Antitrust Committee of the National Association of Attorneys General; former staff counsel with the Federal Trade Commission, as are some of the staff that you have on the committee; and as Director, formerly, of the West Virginia Antitrust Division.

My predecessor, Attorney General Chauncey Browning, came before this committee several times to testify on behalf of reversal of *Illinois Brick*.

This limited reversal would apply only to price-fixing, bid-rigging, and market allocations. It would give standing only to the attorneys general and to the U.S. Attorney General and to certain agricultural cases.

It is quite unfair to have situations of price-fixing in which there is no redress, and we certainly have that. We had about 29 cases filed just in the 1970's by indirect purchasers. Those cases cannot be brought now, and the aggregate data indicate that fewer cases are brought in many of these areas.

It is unfair to the taxpayers, in particular, the taxpayers of West Virginia, similarly to the taxpayers of the other 49 States and jurisdictions. We find that about 95 percent of what the State and local governments buy is not bought directly from manufacturers; it is bought indirectly.

So, about 95 cents of every consumer dollar, we find, is probably in a situation where there can be no action taken for a legal wrong. For every legal remedy, there ought to be legal redress, and there simply is no legal redress here.

The retailers who are the suppliers who would buy these products from manufacturers are really not in an economic position to file suit. First, they are quite often not injured because they will pass on whatever price they buy the product at.

Second, they are not going to sue their own suppliers in a realistic economic world. It is the ultimate buyer who is the one who is probably going to file the suit, and the one in the position to do that should be the State attorney general.

This limited reversal will not result in a great increase in frivolous litigation, simply because the attorneys general are the only ones with standing to proceed. The attorneys general can bring these cases sensibly on behalf of the State as purchasers and as parens patriae; that is, on behalf of the citizens as consumers.

The deterrence of having strong price-fixing actions is pretty clear in our economy, and this bill will certainly strengthen deterrence, for the reasons I have outlined that the ultimate consumer is much more likely to file suit than anyone else.

I believe the State attorneys general in the past decade have shown that they are a major bulwark in enforcing our antitrust laws nationwide, and they need to continue this major role. That is why we would ask the committee to partially reverse *Illinois Brick* as we have asked.

I do have written comments. I would just like to submit them and have them copied by the committee, Senator Hatch.

Senator HATCH. Without objection, we will put them in the record at this point.

Mr. BROWN. Thank you very much, sir.

[The prepared statement and response to questions follow:]

Statement of Charles G. Brown
Attorney General of West Virginia
Vice Chairman, Antitrust Committee
National Association of Attorneys General

June 3, 1986

Good Morning. Thank you Mr. Chairman and Committee Members for giving me this opportunity to offer my testimony in support of the proposed amendments to the Clayton Act. I am here in something of a dual capacity today, both as a State Attorney General and as Vice Chairman of the Antitrust Committee of the National Association of Attorneys General. I support these proposed amendments because I believe that they put the teeth back into the Hart-Scott-Rodino Act.

The Reagan Administration has proposed legislation which would dramatically weaken the antitrust laws. For the past five years, the Administration has conducted a full-scale assault upon our nation's antitrust laws, and now they want to codify a permanent end to vigorous antitrust enforcement. Multibillion-dollar mergers of direct competitors sail through the enforcement agencies, with tangible anticompetitive effects dismissed on the basis of flimsy theoretical arguments about fictional future competitors, giving the clear impression that this Administration never met a merger it did not like. Retail distribution schemes using widely condemned restraints of trade--resale price maintenance, manufacturers and distributors cutting off discounting retailers (often at the request of other dealers), manufacturer-enforced territorial allocation--are condoned by the Administration. And while it pays lip service to the antitrust laws' proscription against horizontal restraints, the fact is that this Administration has cut back on enforcement and initiated precious few new civil actions.

Against this backdrop of sharply diminished enforcement, the Administration now proposes to amend the antitrust laws to foreclose private law enforcement. Ever since 1914, the nation has encouraged private parties to bring actions to enforce the antitrust laws, vindicating private rights and supplementing the limited resources of the government. Not content simply to surrender the economy to industrial privateers for eight years, the Administration has embarked upon a program of unilateral disarmament, seeking to leave the government impotent to deal with market abuses.

It is absurd to suggest that competition among American firms is to blame for the difficulties some domestic firms are having competing with international rivals. Effective foreign competition has not come from monolithic foreign monopolists, but from firms that compete vigorously among themselves as well as with the United States companies. Six major Japanese automobile manufacturers are competing effectively against three and one-half United States firms. Can it seriously be argued that what America needs is a bigger General Motors? The principal cause of the United States trade deficit are well-known: unfavorable monetary exchange rates and lower labor costs in foreign markets--not the antitrust laws.

Most businessmen understand the importance to them and to the nation of competitive markets. They know that they serve their own interests and make their contribution to the economy by pursuing business opportunities, by introducing innovation, by selling quality goods at competitive prices. And they know that their opportunity to do so depends on open access to markets, which the antitrust laws guarantee. The Reagan antitrust package may appeal to those seeking refuge from competition, but it is a threat to those businessmen who welcome the vigorous competition that lies at the heart of our free-enterprise system.

This Administration's lax enforcement of the antitrust laws and its continuing efforts to erode and repeal a century of antitrust works a particularly unfair disadvantage upon small enterprise.

We should take full advantage of market forces. Government's role is to protect against exploitation of market power, to preserve enterpreneurial opportunity, and through its policies to promote a diverse economy. Strong antitrust enforcement furthers these goals. As the United States Supreme Court stated "the antitrust laws are the Magna Carta of free enterprise and are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of fundamental personal freedoms."

The "Illinois Brick" decision blunted state antitrust enforcement and significantly impaired the ability of the State Attorneys General to represent and protect the interest of the ultimate consumer. To some degree that Supreme Court decision deflated the intent of Congress when it enacted the Hart-Scott-Rodino Act.

Under "Illinois Brick" the ultimate consumer is unprotected from the adverse effects of anticompetitive violations. The consumer has no remedy. At present, without the proposed amendment, nothing prevents the price-fixed overcharges from being passed on through the chain to the ultimate consumer. Can we really expect the consumer to be protected by antitrust suits initiated by private plaintiffs?

In most situations, I think the answer is "no." The businesses ongoing relationship with its supplier is a strong disincentive to that business to bring an antiturst suit. The business just passes the overcharge on down the line to the consumer.

The Administration's approach to antitrust over the past five years also has been a clear signal to discourage private enforcement of the antitrust laws. Absent state antitrust enforcement as diminished by "Illinois Brick," the ultimate consumer of price-fixed products is without recourse to protection or recovery.

I believe that the 50 State Attorneys General are at present the major bulkward in enforcement of antitrust nationwide. I believe that the proposed amendments would place an important enforcement tool in the hands of those who can use it best and would restore to the State Attorneys General the crucial ability to correct imbalances in the marketplace.

Thank you.

STATE OF WEST VIRGINIA
OFFICE OF THE ATTORNEY GENERAL
CHARLESTON 25305

CHARLIE BROWN
ATTORNEY GENERAL

June 13, 1986

The Honorable Strom Thurmond
United States Senate
Chairman, Committee on the Judiciary
Washington, D.C. 20510

Dear Senator Thurmond:

I thank you and your Committee for giving me the opportunity to present my testimony on June 3, 1986, in support of Senate Bill 2481, The Antitrust Improvement Act of 1986.

In response to your letter of June 3, and Senator Specter's questions let me respond as follows:

1. In general, I believe that the public benefits to be derived from state antitrust actions under Senate Bill 2481 would be to maintain a competitive marketplace occupied by a sufficient number of actual competitors to insure that goods and services are offered to the consumer at a low and competitive price. I do not believe that Senate Bill 2481 would open the door to "mass consumer cases" because the twin factors of the complexity of antitrust litigation and the slender staff resources of state attorneys general offices would simply require the selection of only significant and high impact cases.

2. At this date, I am not aware of completed empirical studies which establish that antitrust conspiracies are going unchallenged or that deterence is being reduced. However, I sincerely believe that if such an examination were undertaken of state antitrust litigation prior to the Illinois Brick decision in comparison to post Illinois Brick activity, we would find an immediate decrease in both the quantity and quality of state attorney general antitrust action.

Thank you for the opportunity to respond to the Committee's concerns. I would be happy to offer the Committee any other assistance which it finds necessary.

Wishing you the very best of luck,

Sincerely,

Charlie Brown

CHARLIE BROWN
ATTORNEY GENERAL

CB/lp

cc: Members of Judiciary Committee

Senator HATCH. Ms. Budeiri, we would be happy to take your testimony now.

STATEMENT OF PRISCILLA BUDEIRI

Ms. BUDEIRI. Mr. Chairman and members of the committee, I am Priscilla Budeiri and I am a staff attorney for Public Citizen's Congress Watch. I have also submitted testimony today on behalf of Consumers Union and the Consumer Federation of America.

Over 35 million consumers who belong to these groups across the nation appreciate the opportunity to express their views to you about the Consumer Remedies Improvement Act of 1986.

That act deals with a glaring exception to the fundamental American principle that a victim of illegal behavior deserves an opportunity to seek redress. The anomalous rule at issue here prohibits those who have suffered harm due to price-fixing behavior to sue for compensation only because they did not deal directly with the price-fixer.

The illegal behavior causing harm includes criminal felony violations. The victims of this behavior represent a wide variety of consumers, including individual members of families, small businesses, and government entities. All that these consumers ask for and deserve is a fair opportunity to seek compensation if they are injured.

Why should the dealers be the only ones who can sue if automakers set the price of cars? Why should druggists be the only ones who can sue if pharmaceutical companies set the price patients and government Medicare and Medicaid programs must pay for a drug?

Why should a State be precluded from seeking monetary compensation if the price it pays for the cement used to build highways, schools and hospitals was set, but the State did not buy directly from a price-fixer?

None of these results is fair. The Consumer Remedies Improvement Act of 1986 would right this injustice while neither creating injustice for defendants nor overburdening our judicial system.

The act would simply permit the chief legal officer of the Federal or a State government to sue suspected price-fixers on behalf of the government or its citizens if either group suffers antitrust harm, despite the fact that they did not deal directly with the price-fixer.

The reinstatement of the right to sue would not expose defendants to multiple liability, since the act would simultaneously reverse *Hanover Shoe* and allow a defendant to assert the pass-on defense.

The restoration of victims' rights will increase, not decrease, the deterrent effect of the antitrust laws. Price-fixers who currently reap illegal, financial windfall because their direct customers either pass the illegal overcharge on and/or refrain from suing lest they jeopardize an important business relationship, will face the possibility of a suit on behalf of those who really paid for the antitrust violation.

The act does not, however, decrease deterrence by allowing a battery of indirect purchasers or sellers to sue, thereby making each individual recovery not worth the while of the suit.

What the act does is allow the attorney general to make a judgment call on whether an indirect purchaser or seller case is significant enough to file or to pursue.

Finally, the reinstatement of the indirect purchaser's or seller's right to sue will not burden our court system with massive or complex issues. First, the act does not alter the normal rules of standing or the definition of whether injury cognizable under the antitrust laws has occurred.

Thus, indirect purchasers or sellers whose injury is tenuous would still not be allowed to seek relief.

Second, the determination of whether or not to sue to recover indirect injury would be entrusted to the attorney general. The attorney general would, no doubt, consider and weigh the enormity of illegal conduct, the likelihood of winning a suit, and the cost in time and resources before starting litigation.

If the case would be too hard to win for any reason, the attorney general would simply decline to file suit.

In sum, the Consumer Remedies Improvement Act is the perfect combination of the reinstatement of justice for consumers without the initiation of injustice for defendants or the burdening of the judicial system.

Thank you very much.

[The prepared statement and response to questions follow:]

STATEMENT OF

PRISCILLA BUDEIRI
STAFF ATTORNEY
PUBLIC CITIZEN'S CONGRESS WATCH

MARK SILBERGELD
DIRECTOR, WASHINGTON OFFICE
CONSUMERS UNION

AND

GENE KIMMELMAN
LEGISLATIVE DIRECTOR
CONSUMER FEDERATION OF AMERICA

CONCERNING S. 2481
THE CONSUMER REMEDIES IMPROVEMENT ACT OF 1986

BEFORE THE COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

TUESDAY, JUNE 3, 1986

Mr. Chairman and Members of the Committee:

I am Priscilla Budeiri, an attorney with Public Citizen's Congress Watch. I am presenting this statement on behalf of Public Citizen, Consumers Union*, and the Consumer Federation of America**.

We are submitting this statement in support of S. 2481, the Consumer Remedies Improvement Act of 1986. S. 2481 is designed to remedy an exception in the antitrust laws to the basic tenet that every person who is wronged deserves an opportunity to seek redress.

This current inequity is due to a court-fashioned rule that persons or entities paying other than the competitive price for a good or service are nevertheless precluded from seeking compensation if they did not do business directly with a price fixer. S. 2481 removes the "indirect purchaser" obstacle in the situations where its application leads to the most egregious and senseless results: where the government has been harmed in its property and where the state attorney general seeks to sue _parens_ patriae on behalf of its citizens. The legislation does not, however, reach any further, or alter existing rules concerning standing or remoteness of injury. In short, S. 2481 deserves this Committee's support because it constitutes a partial remedy to an existing inequity, but does not cause the problems critics claimed previous legislative proposals created.

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* Consumers Union, the publisher of _Consumer Reports_ Magazine, is a nonprofit membership organization chartered in 1936 to provide information, education, and counsel about consumer goods and services and the management of the family income. Consumers Union's income is derived solely from the sale of _Consumer Reports_, which has a circulation of approximately 3.5 million, its other publications, and films.

** The Consumer Federation of America is a coalition of over 200 national, state and local consumer, senior citizen, labor, farm, cooperative and rural organizations together representing more than 35 million people.

Background:

The current anomaly in the law preventing those who suffer out-of-pocket antitrust injury from seeking compensation is the result of two Supreme Court cases. The Court in Hanover Shoe, Inc. v. United States Machinery Corp., 392 U.S. 481 (1968), was presented with the question of whether a defendant's defense in a price-fixing case may be that the plaintiff should not recover because he passed on the illegal overcharge to his customers. The Court cited two concerns in reaching its decision precluding a pass-on defense. First, the majority opinion states that antitrust litigation would be made too complex if a court had to trace the effects of an illegal overcharge down the chain of purchasers and sellers. Second, the Court concluded that deterrence of antitrust violations would be weakened if the pass-on defense were allowed. If the possible recovery to plaintiffs in price-fixing cases were diminished, plaintiffs might well lose their incentive to sue for redress. Individual plaintiffs' possible recoveries could be diminished to an unacceptable extent, the Court reasoned, if the proceeds of the suit had to be split among all direct and indirect purchasers.

The Supreme Court conclusively precluded antitrust suits by indirect purchasers in its decision in Illinois Brick Co. v.

Illinois, 431 U.S. 720 (1977). Illinois Brick raised the converse issue to the one raised in Hanover Shoe: whether a plaintiff may invoke the pass-on doctrine offensively. So, for example, the state and local government plaintiffs in Illinois Brick alleged that they had bought concrete block from general contractors who had purchased the block from masonry contractors. The masonry contractors, in turn, had purchased the concrete block from the defendants.

The Court held that the offensive use of pass on should not be allowed if the defensive use of pass on is not allowed. It posited three reasons to reach this result. First, the Court concluded that it would not be fair to allow conflicting rules on the availability of the pass-on doctrine for plaintiffs and defendants. Furthermore, if there were conflicting rules on this issue, defendants would be exposed to double recovery.* Second, the Court predicted that antitrust suits would become unmanageably complex if indirect purchasers were allowed to sue. Complexity would be caused by the need to trace the path of the overcharge, the difficulty in allocating damages, and the increase in the number of participants in the litigation. Finally, the Court stated that deterrence would be weakened if indirect purchasers could sue for damages. Following the Hanover Shoe reasoning, the Court concluded that the increased cost of bringing suit due to added complexity coupled with reduced recovery per plaintiff would decrease the attractiveness of bringing a private treble damage action.

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* The Court reasoned that if the pass-on doctrine could be alleged offensively but not defensively, then direct purchasers could sue for damages and recover, only to be followed by an indirect purchasers' suit claiming that the brunt of the price fix was really passed on to them.

The Resulting Anomaly:

The Hanover Shoe-Illinois Brick ban against indirect purchaser suits means that those who have suffered out-of-pocket injury due to a price fix may be precluded from even trying to recover their harm. The exact cost of this ban is not known, but testimony presented by the U.S. Department of Justice less than two years after the Illinois Brick decision was announced estimates that hundreds of millions of dollars in claims had already been affected by the case.*

Uncompensable illegal overcharges are paid by consumers, small businesses, and federal, state, and local governments. For example:

- handicapped consumers who rely on wheelchairs for their independence would be precluded from suing a wheelchair manufacturer engaged in a conspiracy to charge artificially set prices and allocate markets;

- purchasers of automobiles would be banned from seeking compensation under the antitrust laws if there were a conspiracy among auto manufacturers to fix the price of cars;

- businesses that are too small to buy their raw materials directly from the producer and, instead, purchase through a distributor, would not be allowed to sue producers engaged in a price-fixing conspiracy. These small businesses, therefore, would be put at a competitive disadvantage with respect to their competitors who are large enough to buy directly from the producer;

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* Letter from John H. Shenefield, Assistant Attorney General, Antitrust Division, U.S. Department of Justice dated March 22, 1979 concerning H.R. 2060. See Hearings on H.R. 2060 and H.R. 2204, 96th Cong. at 34 (1979).

- indirect purchasers of medicine, like patients and governments (through medicaid and medicare programs) would not be able to seek redress from pharmaceutical companies who engaged in price fixing; and

- federal, state, and local governments that need cement to build highways, schools, and hospitals would be precluded from bringing suit against cement manufacturers who fix prices unless the government unit purchased the cement directly from the manufacturer.

In all the above cases, only the direct purchaser of the price-fixed good would be permitted to sue under the rule in Illinois Brick. Yet, those who are legally permitted to sue often have little incentive to sue. Their lack of incentive may stem from their ability to pass the damages on to their customer and/or their reluctance to jeopardize their business relationships with the price fixers.*

The Consumer Remedies Improvement Act Of 1986 And Responses To Possible Criticisms:

S. 2481 would reopen the possibility of relief under the antitrust laws to a delineated group of indirect purchasers in a carefully controlled set of circumstances. In so doing, the bill would reverse, in part, both the Illinois Brick and the Hanover Shoe decisions.

The main parts of S. 2481 are the following:

1. who may sue: only the United States Attorney General or a State Attorney General;

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* In a price fix costing an estimated $100 million involving the drug tetracycline, only about 10% of the direct purchaser druggists notified chose to file claims with the settlement fund. See Hearings on H.R. 2060 and H.R. 2204, 96th Cong. at 18 (1979).

2. in what circumstances:

(a) when the federal or a state government has been indirectly injured by an illegal scheme to fix prices or allocate markets;

(b) when the state sues parens patriae on behalf of its citizens who have suffered damages as indirect purchasers; and

(c) when the state sues parens patriae on behalf of agricultural producers who have suffered injury as indirect sellers.

3. protections for defendants against double awards:

(a) defendants may assert a pass-on defense in a suit by direct purchasers when they have also been sued by indirect purchasers;

(b) plaintiffs may not recover damages that duplicate amounts previously awarded for the same injury;

(c) claimants suing on behalf of indirect purchasers or sellers must intervene in a suit brought by plaintiffs directly harmed within 6 months of the filing of the suit or else be barred from asserting any claim, and vice versa;

(d) defendants may request consolidation of actions based on the same conduct; and

(e) plaintiffs initiating actions under section 4 of the Clayton Act must notify the United States and states attorneys general, and whenever the attorneys general file a suit on behalf of indirect purchasers or sellers, they must give public notice of the suit.

These provisions of S. 2481 prevent the problems that may be caused by repeal of Illinois Brick.

1. Repeal of Illinois Brick will expose defendants to double liability: Critics of previous efforts to repeal Illinois Brick have claimed that the ability of plaintiffs to use the pass-on doctrine offensively while not allowing defendants to use it defensively will expose defendants to double liability. S. 2481 will not lead to this inequitable result because it allows a

defendant to assert a pass-on defense in a suit by an indirect purchaser or seller.

2. Repeal of Illinois Brick will decrease the deterrent effect of the antitrust laws: One of the Supreme Court's rationales for its Illinois Brick decision was that allowing suits by indirect purchasers would decrease the potential recovery for each plaintiff. Plaintiffs' incentives to bring private treble damage actions, the Court stated, would decrease causing a decrease in the deterrent effect of the antitrust laws.

S. 2481 will have an ameliorative effect on antitrust deterrence. Currently, there is a distinct possibility that price fixers will never face a private treble damage action because those legally allowed to sue may have little or no incentive to do so. S. 2481 would permit the federal or a state attorney general to step in by filing a treble damage action action against the heretofore "immune" price fixer. Furthermore, the amount of recovery by successful indirect purchaser/seller plaintiffs would not be dissipated because the legislation only allows the addition of the government as an indirect purchaser/ seller plaintiff.*

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* The incentive to sue for those directly injured by a price fix will not change significantly. If the direct purchaser is currently able to pass on all or most of the illegal price, he now has little or no incentive to sue. If the direct purchaser is currently absorbing all or most of the price fix, there would no reason for the attorney general to file a case under S. 2481 and the direct purchaser would have the same incentive to sue. In the cases in between, the ability of the attorney general to file suit will be an added deterrent to those contemplating fixing prices. A government suit, however, will never cause an individual plaintiff's recovery to be so minuscule that suits would be discouraged since S. 2481 only enables one indirectly harmed plaintiff to sue.

3. Allowing indirect purchaser/seller suits will greatly complicate antitrust actions: The Supreme Court feared that allowing indirect purchasers to sue would greatly complicate antitrust proceedings. S. 2481 would add only a minimal amount of complexity to antitrust suits for several reasons. First, it does not alter existing rules of standing or proximity of injury. Thus, it is unlikely that indirect purchaser/seller suits will require the complex tracing of damages through unmanageable levels of the distribution chain.

Second, the legislation would only permit the government to bring suits on behalf of indirect purchasers or sellers. The attorney general will no doubt choose to file suit in only the most egregious cases. If a suit is so egregious, it is unlikely that it would be so difficult to determine damages. Whatever difficulty may be added to suit will likely be offset by the importance of bringing the suit.

Summary:

The American judicial system rightfully prides itself in guaranteeing equal justice for all. Justice mandates that those who suffer injury be able to seek compensation. The current rule of Illinois Brick bars those actually harmed by illegal price fixing to seek redress. S. 2481 would correct significant facets of this injustice while not implicating any of the difficulties levied against previous legislative solutions. For these reasons, we strongly support S. 2481.

PUBLIC CITIZEN

Buyers Up ☐ Congress Watch ☐ Critical Mass ☐ Health Research Group ☐ Litigation Group ☐ Tax Group

June 16, 1986

Response of Public Citizen to Senator Specter's question concerning S. 2481: What suggestions do you have to minimize the complexity of the task of tracing damages?

Tracing damages to indirect purchasers or sellers will not be a complex task under the Consumer Remedies Improvement Act of 1986, S. 2481.

First, the mechanics of tracing damages are not complex in practice since most businesses establish their prices in a systematic manner. The method of setting prices may either involve pricing conventions, custom, or rules of thumb. In all these cases, a firm's pricing policy is articulated and, more than likely, set out in company documents. The information contained in these documents, therefore, provides the basis for the calculation of damages to indirect purchasers and sellers.

Second, the calculation of damages in a suit made permissible by S. 2481 will not be unduly complex because of the very limited circumstances in which a suit by an indirect purchaser or seller may be brought. Under S. 2481, only the United States Attorney General or a state's attorney general may bring a suit to redress harm caused to indirect purchasers or sellers. These government officials are charged with the responsibility of enforcing the law albeit with limited resources. The wise allocation of scarce resources precludes embarking on litigation without having a clear picture of damages and how damages will be proven. The attorneys general, therefore, would undoubtedly not authorize the filing of a suit unless there were firm evidence of an egregious antitrust violation with provable damages.

Thus, tracing damages would not be complex in a suit filed under S. 2481.

Senator **Hatch**. Thank you. Let me ask one or two questions. What would you recommend that a court adopt as a limit on this type of litigation? As I mentioned at the outset of our hearing, an overcharge in the case of steel or sugar or transportation could easily touch every person, every American citizen, and maybe those who are not.

Where should the court draw the line? Should it allow every American his or her own lawyer into the case? Does it expand in an aggravated fashion the case action suit phenomenon?

Mr. **Brown**. Thank you, Senator Hatch. I think the *Illinois Brick* override legislation has gone through a number of drafts in the past years and, at times, has given standing, I think, to anyone who is an indirect purchaser to file suit, and you might have, you know, thousands of lawyers in some class action.

This override bill by Senator Metzenbaum and others gives standing only to the State attorneys general, so you would not have a battery of lawyers in there. You would have just the staffs of the attorneys general bringing the action because they would be the only ones with standing to proceed.

In terms of someone buying a product that is remade and remade and remade several times and goes through many channels before it reaches the consumer, you have at some point such a tenuous connection to the buyer, I think the court can simply cut it off. A court can exercise its reasonable power to say there just is not any standing any longer for people who buy this far away from the product.

But I think the key thing is you are limiting the standing to the attorneys general and, in their hopefully sound discretion as either elected representatives of the people or appointed by their Governors or otherwise, to act in the sound discretion, given that they are not only representing taxpayers, but they are utilizing taxpayers' resources in order to file the lawsuits themselves.

Senator **Hatch**. One of the problems we have had is that some attorneys general have used that to reelect themselves or to go for higher offices. Consequently, you have these huge, conglomerated lawsuits that in many cases have benefited nobody.

On the other hand, you know, there is something to what you say, too.

Let me ask you, Ms. Budeiri, what is your response?

Ms. **Budeiri**. I would agree with what the attorney general said, but I would also add and emphasize that only the attorney general can sue, and it would not be in an attorney general's best interest, if he or she were interested in running for higher office, to get the State embroiled in complex and ridiculous litigation which, in the end, the attorney general had no opportunity or real possibility of winning. That would not be something good to put on that person's record and would show poor judgment on that person's part.

Senator **Hatch**. A lot of attorneys general are only there for 4 years and some of this litigation can go on for 10 years. It looks good and they can say, "we are really trying to help the consumers, even though it is costing taxpayers and litigants on both sides tremendous amounts of money."

Ms. **Budeiri**. That is right; I would agree. If taxpayers did see that it was costing them a lot of money but without them getting any recovery, they would think twice about electing this person to higher office.

Senator HATCH. That person may already be the Governor by the time the case is tried. [Laughter.]

That is one of the problems.

Senator METZENBAUM. Do I understand that the chairman does not believe in people in political office aspiring to higher political office?

Senator HATCH. I have noticed a lot of aspiring people during the last day-and-a-half, now that the Senate proceedings are being televised. [Laughter.]

In any event, that has been one of the criticisms. And one of the major worries of those who oppose any kind of change in *Illinois Brick* is that this will not be limited to the attorneys general and that not all attorneys general act in the best interests of the people.

Some of them do act in their best political interest, which may be good or bad in some circumstances. I can point out some instances where I think it has been very atrocious.

Mr. BROWN. I think that is clearly true. I think the other side of the coin, Senator Hatch, is that many corporations do not act in the best interests of the people either and some action needs to be taken when we have this price fixing.

Senator HATCH. We think direct purchasers and direct sellers can stop price-fixing. The best way to have deterrence is to have them in the position of the driver's seat, not get into a 10-year litigation cycle that solves no problems for anybody.

I have to admit, that I see both sides of this issue. If there has been a true antitrust violation on the part of a corporation or corporations, somebody has got to bring them to heel under the antitrust laws; no question about it.

But, generally, we find that direct purchasers and direct sellers can do that.

Ms. BUDEIRI. I would also like to make one more addition to what the attorney general said, and that is that I think a review of the cases will indicate that courts have been able to cut off litigation when appropriate because of such a tenuous connection between the person who is suing and the actual price-fixing behavior.

Senator HATCH. Let me turn to Senator Metzenbaum.

Senator METZENBAUM. Attorney General Brown, the chairman has indicated some concern about the delays that may occur in connection with a case brought by an attorney general. Would you find it acceptable if the chairman should decide to offer an amendment to provide that cases handled by attorneys general of this nature would be handled by the courts on an expedited basis and have a priority position? I think that might solve the chairman's problem.

Mr. BROWN. Sure. I think any time we can put antitrust cases near the top of the docket, the public interest is benefited, Senator Metzenbaum.

Senator HATCH. Other litigants might not feel quite the same way. [Laughter.]

Senator **Metzenbaum**. Well, I did not want this possibility of delay to cause me to lose the strong support of the chairman, so I thought that maybe this would help.

How do you answer the argument, Mr. Brown, that allocating damages between direct and indirect purchasers is too complicated?

Mr. **Brown**. I just think that argument can be a red herring argument. We have difficulties in any complicated economic society in managing economic litigation. It is true that these cases are more difficult than when A shoots B with his bow and arrow in the 16th century tort cases.

But we have to realize that part of the role of the court is in analyzing economic evidence, is in allocating damages. This is certainly complicated, but it is not as complicated as many challenges courts face—many antitrust challenges, such as deciding monopolistic behavior or market share data with mergers.

Complicated commercial cases of all types are difficult, but I think the aggregate data which parens patriae cases certainly permit should be sufficient for the court to allocate the damages.

It is important to realize that retailers will often pass on—in fact, would normally pass on whatever the fixed price was. So the retailers may not be hurt at all. The retailers, therefore, may not file suit, and without the ultimate purchasers being able to file suit, it looks quite likely that the lawsuit may not be filed at all.

Senator **Metzenbaum**. Mr. Brown, what was the States' experience with indirect purchaser suits before *Illinois Brick* was decided in 1977, and were consumers benefiting under the old law?

Mr. **Brown**. My information, Senator Metzenbaum, was that 29 cases of indirect purchases were filed in the 1970's. That was a substantial number; it resulted in millions of dollars being returned to the taxpayers of West Virginia alone, and hundreds of millions of dollars being received nationwide—probably billions.

That was very important that we have these types of recoveries in price-fixing. It was important in the 1970's, but in the Gramm-Rudman era of Federal politics, it is much more important and taxpayers deserve and have to get the recovery when they are overcharged. Otherwise, with the problems taxpayers will be facing on the State and local level, we will have even more shortages in the services that local governments and State governments traditionally have provided.

Senator **Metzenbaum**. Is it offensive to you, Ms. Budeiri, to realize that today there are criminal acts of certain corporations, as well as corporate leadership, and that the American public has no recourse and no way to turn at all as far as the criminality is concerned or as far as the civil damages are concerned?

Ms. **Budeiri**. Absolutely, Senator Metzenbaum. It is unconscionable for persons or corporate entities who engage in felonious criminal activity to get off scot-free, and for the victims of that activity to go without any sort of redress whatsoever.

Senator **Metzenbaum**. Do you feel that the fact that they can be criminally prosecuted is an adequate remedy for the consumer who has been financially affected?

Ms. **Budeiri**. Criminal prosecutions do not reimburse consumers for their losses. While criminal prosecution, of course, is important, my experience as a trial attorney in the U.S. Department of Justice indicates that the most important deterrent to persons contemplating criminal price-fixing behavior is the spectre of a private treble damage suit later on. This explains why many defendants indicted for illegal price-fixing will come into the Justice Department and ask to plead nolo contendere, so that they will not be subject to private treble damage actions without having to go to proof.

Senator **Metzenbaum**. Mr. Brown, have there been cases since 1977 where you believe consumers were harmed, but *Illinois Brick* prevented a suit to obtain compensation?

Mr. **Brown**. Well, there were several which were even filed which resulted in substantially less damages—the cement case multidistrict litigation, the petroleum cases, and the copper tubing litigation.

In addition, I am sure there were cases that were not even filed at all because after the doctrine was well-established law there was no reason even to try.

Senator **Metzenbaum**. Is *Illinois Brick* consistent with other areas of the law—for example, defective products—in requiring that the consumer deal with the manufacturer before he or she can sue?

Mr. **Brown**. Actually, the law is the opposite in the area of defective products. When someone buys a soft drink bottle that explodes or a stove that blows up, the citizen is not just required to sue the retailer, who probably would have not been at fault at all, and then say I hope the retailer will sue this manufacturer.

The consumer can sue the manufacturer of the defective product directly. That only makes common sense in a complicated economic society, just as I believe it only makes common sense to allow consumers who are victims of price-fixing who are indirect purchasers to be allowed to sue.

The Supreme Court, in *Illinois Brick*, for some strange reason adopted the ancient common law doctrine of privity. It is a law that is long out of favor and has been rejected in all 50 jurisdictions either by case law or statute when it comes to defective products and when it comes to dealing with many, many types of tort and contract law.

Senator **Metzenbaum**. Ms. Budeiri, as the author of the legislation, I am frank to tell you that I have some ambivalence. The ambivalence arises from the fact that I think we ought to totally reverse *Illinois Brick* and give the consumer and the individual the right to sue.

As the spokesperson for consumers in connection with this issue, may I ask your view?

Ms. **Budeiri**. It would be preferable if *Illinois Brick* could be totally reversed. However, there is a balance that consumers are willing to strike at this point between fairness to them and their ability to seek redress, as well as responding to some past criticisms of a total *Illinois Brick* reversal.

We do think that the legislation that you have introduced would solve the criticisms that have been levied in the past to total reversal of *Illinois Brick*, as well as at least giving consumers and the Government the opportunity through attorneys general to seek redress.

Senator **Metzenbaum**. I have no further questions, Mr. Chairman.

Senator **Hatch**. All right, thank you.

We want to thank both of you for appearing. We appreciate the testimony you have given and appreciate the time you have put into it.

Senator **Metzenbaum**. Mr. Chairman, at this point I would like to put into the record a letter from the National Association of State Purchasing Officials in support of the measure, and I would also like to ask to include in the record at an earlier point at the opening of the hearing a statement of my own.

Senator **Hatch**. Without objection, it is so ordered.

[The following was received for the record:]

The National Association of State Purchasing Officials

SECRETARIAT: The Council of State Governments, Linda Carroll • Iron Works Pike • P.O. Box 11910 • Lexington, KY 40578 • (606) 252-2291

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Ohio

Wayne Cooper,
CPM
Arizona

June 2, 1986

TO: All Members, Senate Judiciary Committee

SUBJECT: S. 2481

S. 2481 is the product of years of effort to draft a carefully-balanced, narrowly-targeted, fair, and reasonable remedy to the adverse effects of the Illinois Brick decision. As you know, that ruling has caused millions of taxpayer dollars to be wasted in the form of illegally inflated prices paid by governmental entities for indirect purchases.

The National Association of State Purchasing Officials has long been on record as supporting a legislative solution to Illinois Brick. NASPO has recently reaffirmed its position and urges you to indicate your desire for quick and favorable action on this important legislation.

Purchasing officials are only too well aware of the disastrous effects that Illinois Brick has had on our state treasuries. The states buy a wide variety of goods, ranging from art materials for schools, medicine for hospitals, clothing for state prisoners and food for institutions. The states also spend millions of dollars each year to build and maintain highways and to construct state buildings. Approximately 90 percent of these purchases are made indirectly through middlemen. When the state discovers that it has been overcharged through illegal price fixing or bid rigging, it has no legal recourse to recover these overpayments because of the Illinois Brick holding. This legal barrier to recovering public funds and wasted tax dollars must be removed if state governments are to provide governmental services in the most cost-effective manner.

This bill is a very limited, reasonable approach to the problem. It creates a very small class of plaintiffs who can sue under certain limited circumstances. It prohibits multiple or duplicative recovery, and it reduces the number of potential lawsuits. Most importantly, this bill will arm states with the necessary tools to deal with antitrust violators and to recover taxpayer dollars spent in the form of inflated prices for goods purchased by state government.

Please feel free to contact me or any members of the NASPO Executive Committee for further information on our position.

Thankyou for your consideration of our organization's position on this important matter.

Sincerely,

Giulio Mazzone

Giulio Mazzone, President
National Association of State
Purchasing Officials

Senator HATCH. Our next panel will be Dr. John Connor from the Department of Agricultural Economics at Purdue University; Bill Carroll, former Director of the Poultry and Packers Division, Packers and Stockyard Administration, U.S. Department of Agriculture, Washington, DC; and Mark Nestlen, on behalf of the National Grange, Washington, DC.

We are happy to welcome all of you to the committee this morning. We will begin with you, Mr. Connor.

STATEMENT OF A PANEL CONSISTING OF: JOHN M. CONNOR, ASSOCIATE PROFESSOR AND ASSISTANT HEAD FOR RESEARCH IN AGRICULTURAL ECONOMICS, PURDUE UNIVERSITY, WEST LAFAYETTE, IN; WILLIAM V. CARROLL, FORMER DIRECTOR, POULTRY AND PACKERS DIVISION, PACKERS AND STOCKYARD ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC; AND MARK C. NESTLEN, LEGISLATIVE REPRESENTATIVE, THE NATIONAL GRANGE, WASHINGTON, DC

Mr. CONNOR. Thank you, Mr. Chairman and members of the Judiciary Committee. It is a pleasure and a privilege to give testimony before this committee in its deliberations on Senate bill 2481. I am testifying in favor of this bill.

With your permission, Mr. Chairman, I will give a brief summary of what I have to say and enter my full testimony into the record.

Senator HATCH. We will put your full statement in the record.

Mr. CONNOR. One can certainly appreciate the motives of the Supreme Court's decision in *Illinois Brick*. It was, first of all, an attempt to bring about a certain symmetry or consistency with earlier decisions, particularly the Court's *Hanover Shoe* decision.

But, clearly, a more compelling rationale in *Illinois Brick* rested in the Court's concern about protracted and complex treble damage actions; that is, the Court was swayed by the pragmatic considerations about too many suits with too many difficult calculations about compensation.

However, the concern of the Court that private antitrust suits are too numerous or too lengthy, while oft repeated, I think rests on rather thin evidence. On the contrary, the most comprehensive study I was able to find on this subject found that such suits lasted only an average of about 500 days, and they have appeared to have become less complicated over time.

Nor is there much evidence that the number of private suits under Federal antitrust statutes has risen inexorably to clog the courts.

A second point I would like to make concerns the calculation of the apportioning of overcharges. The area of economics most applicable to apportioning of overcharges or underpayments in a vertical subsector is called incidence analysis of marketing margins.

Now, the theory and empirical tools necessary to perform a defensible incidence analysis have been familiar to economists since the 1930's. The skills necessary for estimating the demand and supply relationships that are necessary have been virtually universal among professional applied economists since the 1950's. Indeed, I teach these skills to my beginning graduate students at Purdue University.

It would be a shame, in my opinion, if the justice due to parties injured indirectly by pass-ons of monopolistic overcharges were to be sacrificed on the altar of practicality. It would even be a greater injustice should the claims of impracticality prove baseless.

Now, it is true that precise calculations of portions of overcharges will at times prove difficult, and they will be contested by opposing experts. But difficult is not impossible.

I need not remind this panel, I am sure, that the U.S. agricultural sector is in a state of acute financial stress. The latest available data for 1985 indicate that over 50 percent of U.S. farms are insolvent. The causes of the farm crisis are manifold and some of the unfavorable conditions contributing to this stress may moderate in a few years. But a more permanent source of reduced farm incomes is the structure of the markets to which farmers sell their outputs.

Structurally speaking, agricultural producers find themselves between the proverbial rock and the hard place. Farm production is, of course, one of the most competitively structured U.S sectors. But, like consumers, farmers are numerous and generally cannot engage in collective action in the marketplace.

Perhaps more appropriate to this hearing, agricultural producers face considerable potential market power on the selling side of their operations. Transactions between farmers and first assemblers are generally quite competitive arrangements, but farther down the vertical commodity subsector, domestically-marketed farm products are nearly all sold to food manufacturers. The processing stage of the U.S. food system is, in general, the most concentrated and the most oligopolistic. In 1977, well over half of the U.S. food manufacturing industries were considered moderately or highly concentrated.

The 1982 data on concentration just released last week by the Bureau of the Census show some very substantial increases in food manufacturing. Food manufacturing is now, on average, much more concentrated than the rest of the manufacturing sector, and the gap has widened over the years.

Food retailing and wholesaling industries also show many signs of structural oligopoly.

The bottom line of these structural conditions is the impact that they have on pricing discretion in the food system. High concentration and other departures from competitive markets have been shown repeatedly to raise the profit margins and prices of firms that are insulated from competition. The market power of food manufacturers results in consumer overcharges today of at least $20 billion per year, and the market power of retailers and wholesalers adds several billion to that each year.

There is substantial evidence that the profits of food manufacturers are similarly enhanced by concentration on the buying side of their operations; that is, they have monopsony power as well.

I would like to call attention to two recent statistical studies that have been done. They show a clear inverse relationship between meat packer concentration and the prices paid for fed cattle.

One 3-year study done at the University of Wisconsin, for example, identified 13 regions in which fed cattle are procured. Using their model to predict the amount of underpayments for only the four most concentrated of those regions, they found that cattle prices in the late 1970's were about 24 cents to 47 cents per hundredweight lower than in an effectively competitively region. Put another way, cattlemen in those four regions would have earned $40 to $80 million more in revenues per year if the four largest meat packers had controlled only about 40 percent of the market.

Now, in my statement I have a rather lengthy review of the organization and performance of the U.S. beef subsector. The beef subsector is an important and a very instructive example of a vertical food production and marketing system that would be strongly affected by Senate bill 2481.

In most ways, beef processors and distributors have historically served cattlemen and consumers quite well.

Senator METZENBAUM. Mr. Connor, I wonder if I could interrupt you.

Mr. CONNOR. Yes.

Senator METZENBAUM. As I understand it, the chairman put in a 5-minute rule when he first opened up the meeting; at least that is what I was told Senator Hatch did.

There are several other witnesses, so although you are supporting my bill, I would also say I want to give everybody an opportunity to be heard, and I know the chairman does, who has just arrived.

Mr. CONNOR. I am sorry. I was told 10 minutes yesterday, Senator.

The CHAIRMAN [presiding]. Is your time up? Have you spoken 5 minutes?

Senator METZENBAUM. Well, why do we not give him another minute or so just to summarize?

The CHAIRMAN. Take 2 more minutes to summarize what you have to say and we will put your entire statement in the record.

Mr. CONNOR. Thank you, Senator.

The CHAIRMAN. And we will have 5 minutes for each witness and then put their statements in the record.

Mr. CONNOR. The meat packing industry used to be one of the most competitive manufacturing industries in the whole country, but changes since the early 1970's have changed the structure of that industry enormously.

The market shares of the top meat packers have continued to grow since the early 1970's, and the number of those meat packers has declined. This would tend to pressage further substantial increases in meat packer concentration.

I applaud the introduction of Senate bill 2481. The possibility of price-fixing suits by the State attorneys general on behalf of consumers and agricultural producers should provide strong deterrents for meat packers and other middlemen in the food system.

I am not a legal scholar, but the institutional details and procedures incorporated in this bill appear to represent a realistic solution to several problems related to standing and compensation in price conspiracy cases.

Thank you.

[The prepared statement follows:]

STATEMENT

OF

JOHN M. CONNOR
ASSOCIATE PROFESSOR AND
ASSISTANT HEAD FOR RESEARCH
IN AGRICULTURAL ECONOMICS,
PURDUE UNIVERSITY

Mr. Chairman and members of the Judiciary Committee. It is a pleasure and a privilege to give testimony before this Committee in its deliberations on Senate Bill 6352.

I am in favor of passage of this bill which would amend the Clayton Act so as to permit the State attorneys general to bring antitrust suits on behalf of consumers or agricultural producers against indirect buyers or sellers of their products who may have injured them through anticompetitive behavior. As I understand it, S.6352 is Congress' response to the 1977 Supreme Court decision in the _Illinois Brick_ case. Federal law as it now stands prevents plaintiffs, both buyers and sellers, from claiming injuries resulting from proven antitrust violations, unless the plaintiff had a direct commercial relationship with the violator. In other words, producers who are underpaid by an intermediate party in a chain of transactions because of an antitrust violation that occurred farther down a vertical commodity chain have no standing in court. This is so even though the intermediary may have passed on all or only part of the undercharge to producers. Similarly, _Illinois Brick_ implies that consumers who pay monopolistic overcharges have standing to sue only if retailers are responsible for the antitrust violation. Thus, the _Illinois Brick_ decision has halted or prevented a number of private antitrust suits where the plaintiffs seeking damages were "indirect" buyers or sellers.

One can certainly appreciate the motives of the Supreme Court's decision in _Illinois Brick_. It was, first of all, an attempt to bring about a certain symmetry or consistency with earlier decisions, particularly the Court's 1968 decision in _Hanover Shoe_. In _Hanover Shoe_ it may be recalled that the other party in the suit, United Shoe Machinery Corporation, argued that the admittedly excessive rentals it charged to Hanover Shoe were entirely passed on to its shoe customers and that therefore Hanover Shoe had suffered no cognizable injury (Blair and Kaserman 1985). The Supreme Court rejected United Shoe Machine's argument and ruled that Hanover Shoe was due treble the entire overcharge. Thus, if passing-on is an invalid defense, it is only logical that passing-on be deemed an invalid offensive argument for plaintiffs.

But clearly a more compelling rationale for _Illinois Brick_ rested in the Court's concern for protracted and complex treble-damage actions (Clarkson and Miller 1983). That is, the Court was swayed by the pragmatic consideration that

> "[p]ermitting the use of pass-on theories under §4 essentially would transform treble-damage actions into massive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge... However appealing this attempt to allocate the overcharge might seem in theory, it would add whole new dimensions of complexity to treble-damage suits and seriously undermine their effectiveness."

Firstly, the contention that private antitrust suits are too numerous and unconscionably lengthy, while oft-repeated, rests on thin evidence. On the contrary, the best and probably only study on the subject found that such suits last only about 500 days and appear to be getting less complicated over time (Salop and White 1985). Nor is there much evidence that the number of private suits under federal antitrust statutes has risen inexorably to clog the courts. Between 1971 and 1984, the peak number of such cases occurred in 1977, and it has since declined (ibid.).

Secondly, I assume it is economic "theory" to which the Court refers, but this reference mystifies me. The area of economics most applicable to the aportioning of overcharges (or undercharges) among stages of a vertical commodity subsector is termed an "incidence analysis" of marketing margins. The theory and empirical tools necessary to perform a defensible incidence analysis have been familiar to agricultural economists since the 1930s. The skills needed for estimating the demand and supply relationships that are a necessary first step of an incidence calculation have been virtually universal among applied economists trained since the 1950s.[1] Indeed, each year for the past few years I have passed on these skills to beginning graduate students at Purdue using a standard textbook (Tomek and Robinson 1981). In short, the Justices appear to exaggerate the practical difficulties of estimating the incidence of overcharges, at least for the commodities to which S.3652 applies.

It would be a shame if the justice due to parties injured indirectly by pass-ons of monopolistic overcharges were to be sacrificed on the altar of practicality. It would be even a greater injustice should the claims of impracticality prove baseless. It is true that precise calculations of portions of overcharges incurred by the various participants in a commodity marketing system will at times prove difficult and will always be contested by opposing experts. But that is true of the calculations of the treble damages themselves. More importantly, "difficult" is not "impossible".

It is also true that the buying and selling linkages of the economy are circular and endless. It is possible that underpricing by a grocery retailer, while being passed on to farmers or ranchers, does not stop there. Possibly, the producers may be able to pass on part of the undercharge to their suppliers, though the typical situation in U.S. agriculture makes this unlikely. Clearly, some sort of stopping rules would need to be developed to limit the number of parties to a suit. Again, I would regard this as simply an interesting problem that could be worked out through the application of economic principles in case law rather than a daunting or hopeless task.

The Organization of the U.S. Food System

I need not emphasize that the U.S. agricultural sector is in a state of acute financial stress. The latest reliable data show that in 1985 over 50%

of U.S. farms were insolvent (i.e. had negative cash flows). Financial stress is unevenly distributed across types of farms and geographic areas. About 55% of the insolvent U.S. farms in 1985 were located in the Corn Belt and Plains States, the areas where the major part of meat-animal raising occurs (Jolly, et al. 1983). Moreover, it is the smaller and family-sized commercial operations that were hardest hit by the current agricultural depression.

The causes of the farm crisis are manifold, and some of the unfavorable conditions may moderate in a few years. Lower real interest rates, land prices, and dollar exchange rate will all eventually assist profitability of agriculture. Perhaps public programs aimed at disposing of commodity surpluses, mothballing substantial land resources, or redistributing the farm debt will also have their desired impacts.

But a more permanent source of reduced farm incomes is the structure of the markets from which farmers buy their inputs and to which they sell their outputs. Structurally speaking, agricultural producers find themselves between the proverbial rock and a hard place. Farm production is, of course, one of the most competitively structured U.S. sectors. Manufacturers of farm machinery, many agricultural chemicals, and other farm inputs are among the most concentrated U.S. industries; these inputs are sold through relatively competitive dealer networks to farmers. Thus, in their major purchased inputs, agricultural producers are faced with the possibility of price fixing by oligopolistic manufacturers that is likely to be passed on by wholesale suppliers.

More apropos of this hearing, agricultural producers face considerable potential market power on the selling side of their operations. In most, but not all cases, agricultural producers sell their products to "first handlers" -- wholesale merchants, brokers, cooperatives, or agents who assemble raw farm products mainly for sale to food processors. Depending on the kind of coordinating mechanism and pricing system used, transactions between farmers and first-assemblers are generally quite competitive arrangements. In other cases, however, farmers may sell more directly to processors, and particularly when production or marketing contracts or vertical integration are used as coordinating mechanisms, opportunities for inequitable transactions arise. The proportion of farm production transferred via contracts and integration was about 31% of 1980 value of farm output; in 1960 it was 25% (Harrington 1985:15).

Farther down the vertical commodity subsector, domestically marketed farm products are nearly all sold to food manufacturers. This stage of the U.S. food system is in general the most concentrated and most oligopolistic. In 1977 well over 50% of the U.S. food manufacturing industries were considered moderately or highly concentrated (Connor, et al 1985). The 1982 data on concentration (just released last week) show very substantial increases. Food manufacturing is now on average more concentrated than the rest of manufacturing, and the gap has widened considerably in the post-World War II period. Moreover, the number of companies primarily classified as food manufacturers dropped from 42,000 in 1947 to only about 16,000 today (a 65% decline), whereas the number of companies in the rest of manufacturing rose by at least 50% over the same period. The largest 100 food manufacturers are huge conglomerated firms that control over 75% of the assets of all food manufacturing firms and a similarly large share of the leading positions in food industries.

The food retailing and wholesaling industries also show many signs of structural oligopoly. Sales concentration in U.S. metropolitan areas in 1977 averaged 56% for the top four grocery retailers (Marion, et al. 1985). Supermarket concentration averaged 71%. Because of the unbridled merger wave, grocery retailer concentration is doubtless much higher today. Since the 1950's, food retail concentration has increased even faster than that of food manufacturing. Data on food wholesaler concentration are more difficult to obtain, but the four largest general-line wholesalers appear to control 60% to 90% of their markets. Restaurant and other foodservice sales tend to be unconcentrated, except for fast-food type restaurants where the top four appear to have 50% or more of such sales in the average city.

The bottom line of this survey of structural conditions is the impact that they have on pricing discretion in the food system. High concentration and other departures from competitive market conditions have been shown repeatedly to raise the margins of firms insulated from competitive forces. The numerous studies available on food manufacturing are especially strong and consistent: the market power of food manufacturers results in consumer overcharges today of at least $20 billion each year. Concentrated retail markets also generate consumer overcharges of several billion dollars annually. These compound overcharges result primarily from the exercise of market power on the selling side of the companies' operations -- monopoly power.

There is also substantial evidence that the profits of food manufacturers are enhanced by concentration on the buying side of their operations -- monopsony power. Where buyers are few in number but sellers numerous and not organized collectively, economic theory suggests that long term undercharging by the sellers is feasible and buyer profits will be engrossed. Most of the empirical work substantiating this prediction comes from statistical studies of the effect of procurement concentration on observed farm-gate prices for products bought in regional markets -- meat animals, fresh vegetables, and the like.

Two recent analyses have shown an inverse relationship between meatpacker concentration and the prices paid for fed cattle (Quail, et al. 1986; Schroeter 1986). The Quail, et al study identified thirteen geographic procurement regions for fed cattle in the U.S. Using their model to predict the amount of undercharges in only the four most concentrated regions, they found that cattle prices during 1976-1980 were $0.24 to $0.47 per hundredweight lower than prices in an effectively competitive region. That is, cattlemen in those four regions would have earned $40 million to $80 million more revenues per year from their sale of cattle if the four largest meatpackers had controlled only 40% of the market.[2] Similar analyses found evidence of monopsony power in the case of slaughter hogs (Love and Shuffett

1965; Miller and Harris 1981). While a few other such studies exist, they are difficult to implement because of severe data limitations when the commodities are not traded in public market or are purchased nationwide. Therefore, it is difficult to place an aggregate figure on the annual losses sustained by producers due to monopsony power, but the evidence shows that the losses are real and measurable.

Organization of the Beef Subsector

Cattle producers have been one commodity group with a potentially strong interest in *Illinois Brick*. They have alleged substantial injury because of undercharges initiated by grocery retailers (*Meat Price Investigators Association* 1984). Therefore, it seems especially appropriate to provide some details on the organization of the vertical subsector for beef, competitive conditions, and recent changes in the subsector (this discussion is adapted from Marion and Ward 1985:123-32).

The main features of the U.S. beef subsector are shown in Figure 1. The fed beef subsector has five major stages: cow-calf operations, growing or stocker operations, feedlots, slaughtering and processing, and distribution (wholesaling, retailing, food service). *Beef calf production* is highly dispersed throughout the United States. Thirty states each produced at least 1 percent of the U.S. beef calf crop in 1980. The top five states accounted for 37 percent of the calf crop. Most producers are relatively small; about 70 percent of the beef calves in 1978 came from beef cow herds of fewer than 200 head. Feeder calves are weaned at about 400 pounds; 80 to 90 percent are then placed in growing operations, where they add 300 to 400 pounds while on pasture and roughage. At about 700 to 750 pounds, they are sent to a feedlot for finishing to slaughter weights of 900 to 1,200 pounds.

The production of beef calves, the weaning of these calves, and the placement of feeder cattle on feed are highly seasonal. By varying the weaning age and growing time, seasonal calving patterns are substantially reduced for cattle placed on feed. Additional smoothing occurs within feedlots.

The *growing stage* is the least distinct of the five stages. Growing operations that were integrated with cow-calf operations handled about 40 to 50% of feeder cattle; growing operations owned by feedlots handled an additional 20 to 30%. Total integration of calf production, growing, and feeding is uncommon, accounting for 5 to 9% of fed cattle. Although feedlots have become large, specialized operations, this is not as true of cow-calf and growing operations.

Larger *feedlots* (one-time capacity of 1,000 head or more) accounted for 68 percent of U.S. fed cattle marketings in 1982, nearly double the share in 1962. The 381 feedlots with capacity of 8,000 head or more fed 50 percent of the fed cattle in 1982. The vast majority of these are commercial feedlots (as opposed to farm feedlots) in which almost all the feed is purchased and nearly all the labor is hired. Several of the larger feedlots are owned by large grain-feed companies such as Cargill and Continental. Cargill also owns Excel, the second largest beef packing company in the United States. Packer feeding, however, has gradually declined from over 7% of fed cattle marketings in the mid 1960s to 4.2 % during 1980-1982.

Cattle feeding has shifted sharply to the Western Corn Belt and High Plains since 1960. Five states -- Texas, Nebraska, Kansas, Iowa, and Colorado -- accounted for 66 percent of the fed cattle marketed during 1978-1982. In large part, the shift of feeding to the High Plains occurred because of new milo varieties and expanded irrigation that greatly increased grain supplies in that region. The development of large feedlots was encouraged by scale economies and tax shelters. Depletion of irrigation water and higher pumping costs in the Southern Plains states is expected to reduce future grain production in these states sharply. Cattle feeding may shift north toward the Western Corn Belt. The geographic distribution of steer and heifer slaughter closely parallels the distribution of cattle feeding. Most cattle are slaughtered within 100 miles of where they are fed.

Cull cows and bulls accounted for about one-fifth of the cattle slaughtered during the 1970-1982 period. Cow and bull slaughter is much more dispersed than steer and heifer slaughter, reflecting the distribution of cow-calf operations and dairy herds.

Packer concentration of steer and heifer slaughter in relevant procurement markets is high and increasing. The four leading beef packers in each of the twenty-three major fed cattle states, on average, accounted for 56% of the steers and heifers slaughtered in each state in 1969, 62% in 1972, 66% in 1976, and 81% in 1982. When procurement markets are defined somewht broader as thirteen regional markets, the share of steers and heifers slaughtered by the top four firms (four-firm concentration ratio) ranged from 33 to 97% in 1980 (Quail et al. 1985). Only four regional markets had four-firm concentration ratios below 50%; seven exceeded 70%.

The beef slaughtering and processing industry has undergone dramatic changes in the last twenty-five years. As cattle feeding shifted out of the Eastern Corn Belt, several new packing companies emerged, led by Iowa Beef Packing Co. (IBP). This new generation of packers located large, efficient, specialized beef slaughtering plants in cattle feeding areas and hired workers at substantially lower wages (and fringes) than the old-line packers. The employees of most of the old-line packers were covered by the master labor union contract, which had a cost of living adjustment clause (COLA). The automatic wage increases that were triggered by double-digit inflation during the 1970s exacerbated the cost disadvantage of old-line packers. Several companies closed plants, reopened them under separate ownership, and negotiated new labor contracts.

The growth of Swift Independent and the decline of the Spencer division of Land O'Lakes has resulted in three dominant beef slaughtering companies in the United States. By the end of 1983, the three (IBP, Excel, and Swift Independent) were slaughtering approximately half of the nation's fed beef. It should be noted that the degree of concentration implied by these figures is higher than comparable data available from the Bureau of the Census on value of shipments concentration ratios. This discrepancy is due mainly to classification problems related to facilities that fabricate, but do not slaughter beef.

The most dramatic development in beef packing in the last twenty years is boxed beef. Whereas in the 1960s nearly all beef left the packer as forequarters or hindquarters, much of it is now cut into primal or subprimal cuts by the packer, sealed in vacuum-pack bags, and shipped in cardboard boxes. Boxed beef has grown rapidly in acceptance and accounted for about 43% of beef sold in 1979 and 58% by 1982. Boxed beef has provided an important means for packers to differentiate a commodity - USDA choice carcasses - but also provides many benefits to the packer-retailing stages in transportation and labor cost savings, product quality and shelf life, and merchandising flexibility.

Most small and medium-sized packers do not have boxed beef operations and sell their output in carcass form. The largest three beef packers have boxed beef processing operations. Carcass sales by these companies primarily involve those carcasses that do not meet the standards for boxed beef. Firms engaged in processing carcasses and selling boxed beef often purchase carcasses from other meat packers; thus, the concentration of boxed beef sales is significantly higher than the concentration of steer and heifer slaughter. Four-firm concentration ratios for boxed beef sales were 60% in 1979 and 66% by 1982. A surprising development is a decline in the number of boxed beef processors from 101 companies in 1979 to 87 in 1982. This may be a sign of increasing barriers to entry.

Economies of scale exist in beef slaughtering and processing but are difficult to assess. In the major cattle feeding areas, a specialized slaughtering plant that kills 250,000 head per year using two shifts will apparently realize most of the scale economies available. This represents about 1% of the U.S. fed cattle slaughter in recent years. Economies of scale appear to be greater in boxed beef processing. Most of the new combination beef slaughtering-processing plants have a slaughtering capacity of 500,000 to 1 million head per year.

The beef packing industry seems to be evolving toward two subsets of companies. One includes the slaughterers with large efficient plants (often exceeding 500,000 head annual slaughter) that specialize in a narrow range of cattle (U.S. Choice, yield grade 2s and 3s) and sell much of their output as boxed beef. These companies cater particularly to medium and large supermarket chains. The second subset of packers generally operates smaller plants, slaughters cattle of varying quality, and caters to the smaller, specialized market niches such as restaurants selling U.S. Prime beef, stores handling lower-quality lean beef, and similar markets. The two subsets of the beef packing industry may compete only indirectly both in buying live cattle and in the wholesale meat market.

Most fresh beef is sold through retail supermarkets. Close to half of the beef sold through retail stores is sold directly by packers to supermarket chains, which usually perform the warehousing and distribution functions. The remaining half is largely sold to grocery wholesalers, which service independent supermarkets and small chains, or to specialized meat wholesalers.

Food service outlets also sell substantial volumes of beef. Fast food hamburger chains are an important part of the market for ground beef products and hence the demand for cull cows and beef trimmings. Beef sold to food service firms usually goes through one or two intermediate stages. Independent beef processing-fabricating firms buy beef on a negotiated price basis from packers and fabricate specified cuts for food service companies. Fabricated beef products are either delivered directly to retail outlets by beef fabricators or channeled through food service distributors. Large, limited menu food service companies seldom perform either the beef fabricating or distribution functions. The food service firm's purchasing department controls the procurement process through a system of contracts and distribution agreements with both feed fabricators and food service distributors.

Methods of Coordination in the Beef Subsector

The coordination task in the beef subsector is relatively difficult. The seasonal output of atomistic and geographically dispersed cow-calf producers must be synchronized with the demands of meat packers and retailers for a stable supply of consistent quality beef. This synchronizing task is performed by growers (also called stockers or backgrounders) and feedlots but largely without contracts or vertical integration to provide greater vertical control.

Auctions and order buyers are the primary means by which small lots of feeder cattle are sorted and consolidated into truckloads of relatively homogeneous cattle for shipment to feedlots. In the exchange between feedlots and packers, there has been a sharp decline in the importance of terminals and an offsetting increase in direct marketing. Whereas 39% of steer and heifers were sold direct in 1960, this had increased to 88% by 1982. Although contracts or formula-pricing arrangements are rarely used in feedlot-packer exchange, the price packers are willing to pay for fed cattle depends on the price they expect to receive in the wholesale meat market. Since the National Provisioner Yellow Sheet is the most heavily used source of price information for the wholesale market, the prices of fed cattle tend to follow the Yellow Sheet quotes.

Packer sales of carcass beef are predominantly formula priced using the Yellow Sheet. One-third or less of carcass sales are priced by private negotiation or offer-acceptance arrangements. In contrast to carcass pricing, most boxed beef sales involve negotiated prices. A major exception is IBPs Cattle-Pak, which is formula priced based on the Yellow Sheet. Formula pricing is also heavily used in cost-plus procurement arrangements between food service firms and beef fabricators.

Formula pricing is controversial because of concerns about the price base most commonly used, the Yellow Sheet. Concerns include: 1) the small volume of negotiaced prices on which price reports are based (several large chains that negotiate prices refuse to report them to the National Provisioner); 2) price quotes are sometimes based on no trades; and 3) the small number of reported trades may allow price manipulation, particularly via packer-to-packer trades. Although research on the Yellow Sheet provides some support for the first two concerns, the existence of price manipulation has been neither confirmed nor refuted.

Suggested solutions to concerns about the Yellow Sheet include abolishing formula pricing, instituting mandatory price reporting or instituting electronic marketing. A pilot electronic marketing system for wholesale beef was not widely enough accepted to be commercially viable. Most observers are reluctant to advocate elimination of formula pricing because of low transaction costs, the benefits to small buyers and sellers, and the strong preference of many traders.

Although contracting and vertical integration is not widespread in the beef subsector, two relatively new vertical arrangements deserve note. One is the joint venture between IBP and North West Feeders Cooperatives (NWFC). Six feedlots in Idaho and Washington formed a cooperative and entered into a five-year agreement with IBP to supply about three-fourths of the slaughter needs of two IBP plants. IBP and NWFC share profits or losses from feeding, slaughtering, processing, and distributing the cattle supplied by NWFC under the agreement.

A more complex vertical network was organized by Keystone Beef, a major fabricator of ground beef for McDonald's restaurants. A subsidiary of Cargill, Inc. (Caprock feedlots) purchases and feeds feeder cattle for Keystone. These cattle are then custom slaughtered by Excel, another Cargill subsidiary, processed into boxed beef and shipped to Keystone, where they are further processed into hamburgers that meet McDonald's specifications. This contractually tied network is an attempt to ensure dependable supplies that meet rigid specifications regardless of the stage of the cattle cycle.

Agricultural cooperatives play a minor role in the beef subsector. Cooperatives operate some feeder cattle auctions and may help connect buyers and sellers of fed cattle. Land O'Lakes is the only cooperative that has had a significant involvement in beef packing. In 1978, Land O'Lakes acquired Spencer Packing Co., one of the largest five beef slaughterers at the time. In 1983, Land O'Lakes attempted to sell the Spencer plants to Excel but was blocked by private antitrust action.

Government programs have long played a role in beef grading and health and sanitation inspections. Federal grades for beef facilitate coordination in the subsector. Import limitations on processed beef (mostly frozen) are the primary means by which the federal government influences beef supplies or prices. Imports would undoubtedly be much higher than the present 1 billion poiunds without import restrictions.

Subsector Performance

Given the series of major changes that have affected the beef subsector since 1960, the subsector has demonstrated both adaptability and organizational progressiveness. New firms that entered the cattle feeding and beef packing stages have had a particularly strong effect on subsector progressiveness.

There has been a cost to this progressiveness, particularly for employees of meat packing companies and the owners and managers of "old-line" packing plants and many smaller slaughtering plants. Hourly employees have seen many jobs eliminated and their wages and fringes reduced substantially. Some packers have been criticized for encouraging rapid turnover of employees and recruiting immigrants and foreign nationals willing to work for lower wages. It seems possible that, after a period of labor-management accommodation in the early 1980s, the beef packing industry may be in for a period of labor unrest.

The counterargument is that new-generation firms have substantially reduced costs in the beef subsector and provided an infusion of keen competition. Technological changes in meat packing such as on-rail slaughtering and on-line processing have increased labor productivity and reduced the level of skills required. Red meat output (in pounds) per man-hour increased by 49% from 1960 to 1970 and by 20% from 1970 to 1980 in meat packing plants. The introduction of boxed beef by newer firms has brought significant labor, transportation, and marketing efficiencies to the subsector.

Prices and profits in the beef subsector have been highly variable. Prices are the most volatile for calves, followed by feeder cattle and then fed steers and heifers. The beef cycle persists, although its length is more difficult to predict. Since current fed beef supplies reflect breeding and marketing decisions made over two years ago by cow-calf producers, it is difficult to correct shortages or surpluses quickly.

Considering the complexity of coordination in the beef subsector, market period coordination is quite good. Seasonal calf production is largely smoothed out by stockers and feeders. The quality of fed beef has gradually changed in response to consumer desires for leaner beef and packer-retailer desires for high-yielding cattle.

Price information and formula pricing remain major issues in the subsector. Although there appears to be a sufficient volume of negotiated trades on carcass beef to discover equilibrium prices, only a tiny fraction are included in price reports. The volume of carcass trades is also steadily declining. The current price reporting system for carcass beef is vulnerable to manipulation and selective reporting. Because of formula pricing, distortions in reported carcass prices affect prices throughout the wholesale meat and fed cattle markets.

The changes affecting the subsector have resulted in relatively high and increasing levels of concentration in the procurement of live cattle and the sale of boxed beef. These appear to be the markets in the subsector where some deterioration of competitive forces may be occurring. Thus, feeders in some areas may be receiving lower prices for their cattle than they would in more competitive markets.

The development and acceptance of boxed beef has been the most important change affecting the beef subsector since the mid-1960s. Within ten years, most industry observers expect the U.S. beef subsector will have completed its conversion to this form of meat handling. Boxed beef subprimals have gradually become smaller and freer of bone and fat, and require less store-level fabrication. It appears only a matter of time before boxed beef processors will provide packaged case-ready retail cuts. At that point, the development of packer brands of fresh beef cuts would be feasible. Fresh beef marketing could become similar to the marketing of weiners and bacon. From the point of view of competition, this could have far-reaching implications. As in much of food manufacturing, product differentiation by processors is a major source of consumer overcharges (Connor, et al. 1985). Because meatpacking is such a huge and heretofore price-competitive industry, the widespread introduction of branded fresh meats in a concentrated industry could raise overcharges from practically zero to as much as $300 million per year (1982 dollars).

Concluding Comments

The beef subsector is an important and instructive example of a vertical food production and marketing system that would be affected by S.6352. This example shows the complexity of a modern subsector -- the many stages and methods of supply coordination. In most ways, beef processors and distributors have historically served both cattlemen and consumers well, yielding variable but fair prices to both groups. The subsector has implemented a number of technological and institutional changes, many of which have led to technological progress.

However, several segments of the subsector are undergoing momentous changes. Many cattle producers are facing adverse prices, declining consumer demand, and financial stress from which many will not survive. Some of these conditions may prove to be temporary. But one apparent source of low prices is unlikely to go away soon -- the looming market power of meatpackers which may derive in part from a cooperative relationship with food distributors.

The meatpacking industry of the 1960s was often cited as an exemplar of a competitive food manufacturing industry. Thousands of meatpackers bought and sold essentially homogeneous commodities under conditions of "cut-throat" pricing. Margins and profits were low and highly variable from year to year. The meatpacking industry had undergone a steady decline from a tight oligopoly of five dominant firms in 1920 to one of the most atomistic industries by the early 1970s, partly a result of successful antitrust intervention -- the Packers Consent Decree of 1920 (Yeagar 1981).

Since the early 1970s, the structure of the meatpacking industry has changed enormously. The major old-line meatpackers (Swift, Armour, and Wilson) were snapped up during the conglomerate merger craze of the late 1960s. Then most of them were divested in the early 1980s and are once again financially independent, if not prosperous. The really interesting change was the introduction of the boxed-beef technology. Iowa Beef Processors (IBP), often credited with being the innovator in this industry, was established in only 1961. By 1975 it was already the tenth-ranked U.S. food manufacturer by sales (Connor and Mather 1978). By dint of a lower-cost technology, lower wages, agressive marketing, and desire of many retailers to do without their back-room meatcutters, boxed beef quickly made inroads on the meatpackers offering only carcasses. With the handwriting on the wall, the two leading boxed-beef packers (IPB and Excel) were soon acquired (by Occidental Petroleum in 1981 and Cargill in 1979, respectively). The market shares of the top boxed-beef packers have continued to grow ever since. Moreover, boxed beef, already accounting for three-fifths of meatpacking, is expected to garner at least 75% to 80% of the volume of meatpacking and packer fabrication of retail cuts most of the rest, under a wide range of assumptions (Diaz, Farris, and Litzenberg 1986). Combined with the downward tendency in numbers of boxed-beef companies, these trends presage further substantial increases in concentration on both the selling side and buying side of the meatpacking industry. The incentives and ability to raise profits through overcharges to retailers or undercharges to suppliers to meat animals will be greater than ever.

I applaud the introduction of S.6352. The possibility of price-fixing suits by consumers or agricultural producers should provide a strong deterrence for meatpackers and other middlemen who buy or supply the plaintiffs from a remote position in the food system. I am not a legal scholar, but the institutional details and procedures incorporated in S.6352 appear to represent a realistic solution to several problems related to standing in price conspiracy cases. The pursuit of cases through the instrumentality of the State attourneys general will probably increase the incentives of indirect purchasers or sellers to detect and sue violators without diminishing the ability to detect by direct purchasers or sellers (Harris and Sullivan 1979; Shepherd 1985). The arguments by Landes and Posner (1979) that only direct victims have sufficient incentive to deter price fixing seem flawed (Mueller 1984). Middlemen in the food system often are reluctant to upset long-standing business relationships that have evolved to preserve business peace and prevent the outbreak of commercial war.

It also appears that S.6352 has been crafted with the concerns of the courts in mind. In the case of multiple claims by direct and indirect plaintiffs, the bill encourages consolidation of the cases. (There is not much evidence that private antitrust suits have remained unconsolidated in the past (Salop and White 1985)). The role of the State attourneys general in most cases will discourage frivolous suits brought to harass honest businessmen. And, finally, I see no insuperable obstacles to calculating fairly precisely the degrees of incidence incurred by victims of overcharges or undercharges at two or more levels of a vertically linked marketing chain.

Notes

1 The calculations of the incidence of an overcharge or undercharge on two or more participants at different stages in a commodity marketing system requires the empirical estimation of demand curves for each stage of the system. While refinements have been made since the 1950s, the calculation of such curves usually involves single-equation econometric estimation from observed historical data. In many cases, the demand curves required may already be available from the many hundreds of such studies published in professional economics journals during the last 40 years (or such studies may be readily updated using publically available data). In other cases the demand curves have been calculated but are unpublished because certain parameters derived from them (called elasticities) are necessary components of more complex models used for every-day policy analysis by private firms or government agencies. In the latter case, the necessary data could be obtained fairly quickly through the discovery process during an antitrust trial.

Of course there are likely to be some knotty problems. Demand estimates are more available for major crops and large components of consumer food purchases (e.g., "steers" and "all beef") than they are for minor crops (e.g., ginseng). Also, more is known publically about the demand for consumer foods than for semiprocessed or industrial ingredients (e.g., high fructose corn syrup). Finally, at times there may be disagreements about the exact functional form or most appropriate data set to be used for estimation, but in most cases the range of disagreement will be quite small. In most cases, these problems can be handled by obtaining the necessary economic data during discovery and through expert testimony.

[2] The four cattle-procurement regions were irregularly-shaped areas of about 200 to 400 miles in diameter centered in: (1) Greeley, Colorado, (2) Iowa, (3) Wichita, Kansas, and (4) the Oklahoma-Texas "Panhandle."

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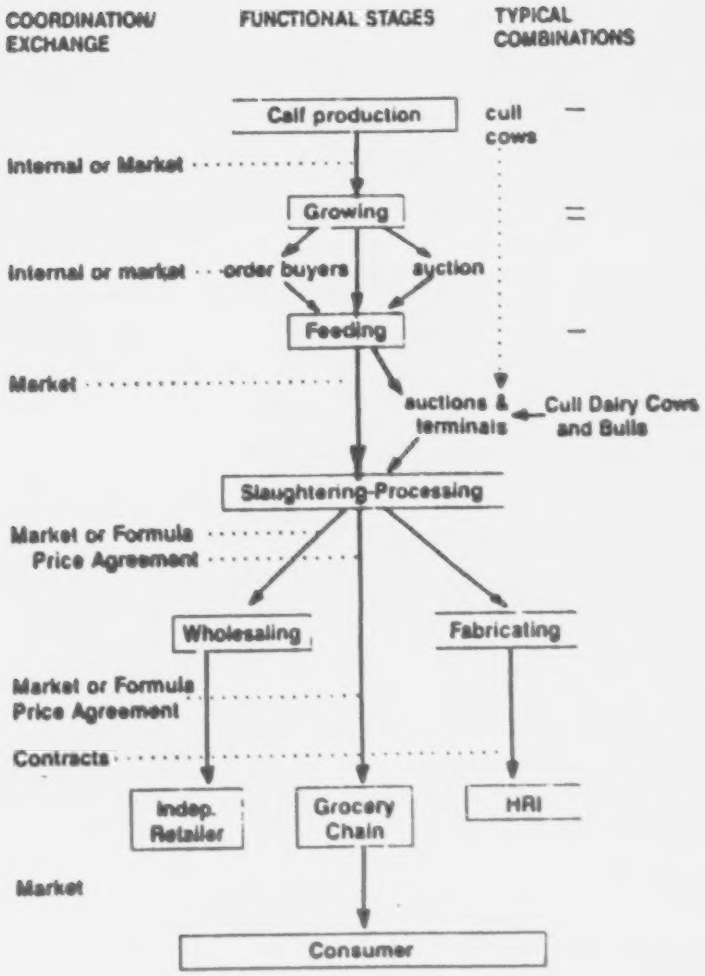
COORDINATION/ EXCHANGE
FUNCTIONAL STAGES
TYPICAL COMBINATIONS
Calf production
cull cows
Internal or Market
Growing
Internal or market
order buyers
auction
Feeding
Market
auctions & terminals
Cull Dairy Cows and Bulls
Slaughtering-Processing
Market or Formula Price Agreement
Wholesaling
Fabricating
Market or Formula Price Agreement
Contracts
Indep. Retailer
Grocery Chain
HRI
Market
Consumer

Figure 1. Organization of the Beef Subsector

The CHAIRMAN. Mr. Carroll, we would be glad to hear from you.

STATEMENT OF WILLIAM V. CARROLL

Mr. CARROLL. Thank you, Mr. Chairman, members of the committee. I am especially honored at this stage of my career for the opportunity to appear before a Senate committee to testify in the matter of this bill to amend the Clayton Act regarding antitrust enforcement.

After having read some of the accounts of previous hearings on this subject with the same intent, I feel somewhat like Glenn Freie. I am neither an attorney nor an economist, and unlike Glenn, I am not even a farmer.

However, I did have a 30-year career in the meatpacking industry, and then joined the U.S. Department of Agriculture, with the agency that had the responsibility for enforcing the Packers and Stockyards Act of 1921.

The objective of the act is to safeguard farmers and ranchers from unfair, deceptive, monopolistic practices in the marketing of their livestock, and to assure that they receive full market value for the products that they produce.

The impetus for the act was in 1917 when President Woodrow Wilson requested the Federal Trade Commission to investigate the practices in the livestock and meatpacking industries.

In 1918 and 1919, the Federal Trade Commission submitted massive reports to the President answering his question and stating that there was conclusive evidence that there did exist monopolies, controls, trusts, combinations, conspiracies, or restraints of trade out of harmony with the law and in the public interest.

Of course, since 1921, there have been some radical changes in the livestock and meatpacking industry, but one factor has remained constant. The producer is in a unique and precarious position in the marketing of his product.

In economic terms, his industry segment is just about perfectly competitively structured. This means that he has little or no control over the prices he pays for his inputs—feed, medicine, and so forth—nor for the prices he receives for his output, which is slaughter-ready cattle.

Because of this vulnerable position, these producers, and, as a matter of fact, all producers of agricultural commodities, need particular protection against collusive behavior and other antitrust violations, and this should obtain whether they are direct or indirect buyers or sellers.

High market concentration has conferred market power on several firms in the livestock and meatpacking industries that may be little different from conditions that existed in 1921, here 65 years later.

As firms with this market power increase their share of the market, numerous meatpackers, primarily slaughterers of fed cattle, steers, and heifers, have gone out of business. As these meatpackers left the market, the producers have lost part of their market; that is, there are less and less buyers all the time.

It is not economical to transport livestock any great distances; they have to sell them close to where their farm is located. So, frequently, they are in a take-it-or-leave-it situation.

Several years ago, in attempting to protect themselves, a group of livestock producers gathered together and sued meatpackers and chainstores. However, before a decision was reached in the chainstore litigation, the decision came down in the *Illinois Brick* case holding that indirect sellers could not be sued. The fifth circuit applied the *Illinois Brick* theory to the case of indirect purchasers as well, and so the case against the chainstores was dismissed.

Now, while there may be some evidence in some industries or in some contractual arrangements to support the *Illinois Brick* decision, such is not the case in the livestock producer, meatpacker, and chainstore transactional relationship.

From my experience selling to chainstores when I was in the industry, one of the things that they fear the most is that some of their competitors will be buying at prices that are cheaper than they buy.

Most of the beef that was sold in the principal chainstores in the country during this period was USDA choice quality beef, so quality-wise the chainstores were equal; they were all selling the same type of beef. But price-wise, they needed some arrangement so that they could be more equal, so their competitors would not be buying at a lesser price.

So they started buying on a formula basis. This formula was an agreed-upon differential over the price quoted by a national marketing news reporting service, almost always a private service, known as the National Provisioner or the Yellow Sheet.

Any difference in the formula represented the cost of freight, plus any charge for a special trim or a special handling. But all of the buyers started from the same point, the same number. To put it more simply, all the chainstores, say, in the Detroit area were paying the same price; none was undercut.

The irony of the whole arrangement is that the livestock producer at the other end of the chain was, in many cases, selling his live cattle at a price that was based on a quotation from the same market news reporting service. This came about when meatpackers began buying live cattle on what they call a dressed weight basis; that is, using a carcass price.

In some cases, cattle buyers would calculate a live price by starting from the quoted carcass price, applying their estimated yield, their drop credit, and their kill costs to come up with a live weight price.

There is further irony in the arrangement when you consider that the livestock producer had no input to the establishment or the discovery of this carcass price, and the reason for that was that he neither bought nor sold carcass beef.

It appears that all legal avenues against the indirect purchasers have been explored without success by these livestock producers, so that action on the present bill is the remaining hope for them; not only for livestock producers, however, but for producers of all agricultural commodities.

All areas of the food processing and distribution industries are becoming more concentrated. More market power is accruing to fewer firms, and this market power is being exercised.

During the periods when agriculture is experiencing widespread depressed conditions, such as the present time, it is very likely that concentrations in the marketing chain will artificially depress market prices.

If the farmers are thus victimized by price-fixers in the marketing chain, they, the farmers, should have access to the courts.

Senator METZENBAUM [presiding]. Mr. Carroll, your time has expired. Can you just wind up your remarks?

Mr. CARROLL. All right.

Senator METZENBAUM. Your entire statement will be in the record.

Mr. CARROLL. Thank you, Senator.

They should have access to the courts to recover the damages. Failure to permit farmers to sue in these situations is a grave injustice.

Thank you, Senator.

[The prepared statement follows:]

STATEMENT
OF
WILLIAM V. CARROLL

Mr. Chairman and members of the Committee. I am especially honored at this stage of my career for the opportunity to appear before your Committee to testify in the matter of S.2481, a bill to amend the Clayton Act regarding antitrust enforcement.

After having read some accounts of the hearings on previous bills dealing with the same subject and with the same intent, I feel a little bit like Glenn Freie. I am neither an economist nor an attorney and - unlike Glenn - I'm not a farmer! But I have spent a full career in the meat packing industry - over 30 years - and 14 years in the U.S. Dept. of Agriculture with an agency that was charged with regulating the livestock, meatpacking and poultry industries, enforcing the Packers and Stockyards Act of 1921.

The objective of the Packers and Stockyards Act is to safeguard farmers and ranchers from unfair, deceptive, unjustly discriminatory and monopolistic practices in the marketing of their livestock, and to assure they will receive the true market value of their livestock.

Impetus for the enactment of the P & S Act came from an investigation by the Federal Trade Commission conditions in the livestock and meat industries. This investigation was requested by President Woodrow Wilson in 1917. In 1918 and in 1919 FTC submitted a massive report to the president answering his question that there was conclusive evidence of the existence of 'monopolies, controls, trusts, combinations, conspiracies, or restraints of trade out of harmony with the law and the public interest.'[1]

Radical changes have occurred in the livestock and meatpacking industries since 1921. But one factor has remained constant - the livestock producer is in an unique and precarious position in the marketing of his product. In economic terms, his industry segment is just about perfectly competitively structured. This means he has no control over the prices he pays for his inputs (feed, medicine, etc.) nor for the prices he receives for his output (slaughter ready cattle).

Because of this vulnerable position in the marketplace, livestock producers and, as a matter of fact, all producers of agricultural commodities need particular protection from collusive behavior and other antitrust violations engaged in by buyers of their commodities downstream in the marketing chain. This should obtain whether they are direct or indirect buyers or sellers!

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[1] FTC. Report to the Federal Trade Commission on the Meat Packing Industry 392. (1919).

High market concentration has conferred a market power on several firms in the livestock and meatpacking industries that may be little different from conditions which existed in 1921. As firms with this market power increase their share of the market numerous meatpackers, primarily steer and heifer slaughterers, have gone out of business.

As these meatpackers have left the market, livestock producers have found themselves with fewer and fewer slaughters in their area available to bid on their livestock. Because it is not economical to truck livestock long distances, the producers are faced with what is almost a "take it or leave it" situation.

In order to protect themselves against this developing threat, a number of livestock producers have organized a group to take action against what they perceive as antitrust violations. In their original lawsuits, they included a number of supermarket chainstores. Before the lawsuit was heard, the decision in the Illinois Brick case was handed down, holding that indirect sellers could not be sued. The Fifth Circuit Court of Appeals applied the Illinois Brick theory to the case of indirect sellers, and the case against the chainstores was dismissed. The farmers were denied the opportunity to maintain private damage actions against all but first handlers of farm products.

While there may be evidence in some industries or in some contractual arrangements to support the Illinois Brick decision, such is not the case in the livestock producer, meatpacker, chainstore transactional relationship.

From my experience selling to chainstores when I was in the meatpacking industry, I learned that the one thing they strove to avoid was to have a competitor buy at a cheaper price than they did. During the period of time we are discussing, most of the chainstores bought USDA Choice graded beef, either steers or heifers, depending on local preference. So, quality-wise they were equal. In order to stay equal price-wise they purchased their carcass beef on a formula basis. The formula was an agreed upon differential over the price quoted by a national market news reporting service, almost always a private reporting service known as the National Provisioner "Yellow Sheet."

Any differential in the formula represented the cost of freight from the shipping plant plus any charge for special trim, special handling, etc. In this way all chainstores buying on a formula basis were paying the same price, based on a quotation in the Yellow Sheet. Everyone started from the same number. To put it more simply all the chainstores, say in the Detroit area, were paying the same price - none was undercut.

The irony of this whole arrangement is that the livestock producer, at the other end of the chain, was, in most cases, selling his cattle at that same price based on a quotation from the same market news reporting service. This came about when meatpackers began buying live cattle on a "dressed weight" basis, i.e. using a carcass price. Or, in some cases, cattle buyers would calculate a live price by starting from the quoted carcass price, applying their estimate yield, drop credit and kill cost to come up with a live weight price.

There is further irony in the arrangement when you consider that the livestock producer has no input to the establishment or discovery of the price quoted as the "market price." Why? Because he neither buys nor sells beef in carcass form.

It appears that all legal avenues against the indirect purchasers have been explored, without success, by livestock producers. Hence, action on the bill S 2481, is the remaining hope for them - and not only for livestock producers but for all producers of farm commodities. All areas of the food processing and distribution industries are becoming more concentrated. More market power is accruing to fewer firms, and this market power is being exercised. During periods when agriculture is experiencing widespread depressed conditions, it is very likely that concentrations in the marketing chain will artificially depress farm prices. If farmers are thus victimized by price fixers in the marketing chain, they, the farmers, should have access to the courts to recover damages. Failure to permit farmers to sue in these situations is a grave injustice.

There is, of course, a fundamental difference between the situation in Illinois Brick, (which involves an artificially high price paid on the purchase of bricks by a middleman who in turn resells the produce;) and the farmers' situation involving an artificially depressed price received in the sale of their commodities. First, the relative numbers and concentrations of market power of the parties is radically different in one case than the other. The situation involving the fix of sales price involves relatively few sellers, more middlemen buyers and still greater number of indirect purchasers. The farmers situation is almost the converse; involving great numbers of sellers selling product into a market controlled or fixed by relatively few beef processors and supermarket chains.

Second, the Illinois Brick situation involves a higher price charged to a buyer which the Supreme Court theorizes may be absorbed or passed on to the indirect purchaser. But the farmer's situation involves receipt of less than market value for their products.k The fundamental difficulty with the application of Illinois Brick to the farm situation is the logical inability of a middleman to "absorb" an undercharge for the value of commodities sold by farmers. In other words, there is no way for the farmer to "pass on" the loss of revenue.

While a brick wholesaler may or may not pass on to the next purchaser all or a portion of the higher price he paid because of the price fix, and while that "pass on" may impose the difficulties of evidence and proof perceived by the Supreme Court in the Illinois Brick case; in the case of a sale by a farmer into a fixed market at an artificially low price, there is no such problem of accounting or proof because there is literally nothing to pass on. There is only the fact that farmer did nor receive that which he would have received in a free market.

In research conducted by Marshall B. Clinard of the Justice Department, and entitles, Corporate Ethics and Crime, (three out of four of the retired mid-level corporate executives who took part in the study said, "American industry cannot police itself and therefore must be regulated by government."

> According to several executives, the ethical patterns within a corporation or within an industry were improved and maintained where the government had taken strong enforcement actions in the past. A number of them, for example, pointed out the continuing effects of price-fixing and antimonpoly enforcement actions brought by the government years ago. Support for this view comes from a study of criminal antitrust prosecutions in the bread industry which had significant subsequent deterrence was surprising in that none of the executives went to jail. In this case, deterrence was strengthened by private civil damage suits that followed in the wake of criminal prosecution. Moreover, prior enforcement actions, according to the executives, had not only affected compliance in the particular area in which they were brought, but also had intended to affect compliance with government regulations generally. Surveying the evidence, two writers in the area of corporate crime have concluded that deterrence is quite effective, particularly with specific corporations or in the case of executives who have been prosecuted successfully. (Braithwaite and Geis, 1982)[2]

It has been a pleasure to appear before this Committee and to testify on S. 2481. I favor its enactment. It can alleviate an egregious condition on livestock producers and other damaged by indirect purchasers. It accomplishes this without affecting the rights of other claimants in antitrust actions and, by the use of carefully considered language, without imposing an undue burden on our courts.

Thank you for the opportunity.

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[2] CORPORATE ETHICS AND CRIME, 1983, pp. 157 and 158 (This document is the result of research supported by Grant Number 81-IJ-CX-0035 awarded by the National Institute of Justice, U.S. Department of Justice under the Justice System Improvement Act of 1979.)

Senator METZENBAUM. Thank you very much, Mr. Carroll. Mr. Nestlen.

STATEMENT OF MARK C. NESTLEN

Mr. NESTLEN. Thank you, Mr. Chairman, members of the committee. I am Mark Nestlen, legislative representative from the National Grange, which has offices here in Washington. I will summarize my statement and appreciate it if the extension of my remarks will be placed in the record.

The National Grange is a general farm organization that represents over 400,000 members in both farm and rural areas in 41 States. Since our beginning in 1867, the National Grange has been deeply involved with issues of national interest, as well as the special and vital interests of the agricultural economy.

Since its inception, the Grange has been truly concerned with the problems of monopolies, and it has been a key figure in the passage of antitrust laws. The Granger movement initiated the radical but gradual revolution of American ideas, which ultimately brought large corporate enterprises under Government regulation.

The anti-monopoly and reform practices which arose during the Granger movement, extended their direct effect upon the passage of the Granger laws.

According to Judge Thurman Arnold, the Grange's influence on antitrust laws was more indirect than its influence on public utility legislation. However, he stated, and I quote, "I have no doubt that without the Grange movement against monopoly, there would have been no Sherman Act."

It is with this in mind, Mr. Chairman, that I appear before you and your committee today to testify on S. 2481, the Antitrust Improvements Act of 1986. It is both a pleasure and an honor to appear before this committee, to express the Grange's support for a bill whose passage is vital in retaining the family farm structure of agriculture.

The *Illinois Brick* decision unfairly affects farmers, because it fails to recognize the unique competitive structure of the food and fiber system. It is this unique competitive structure that I will focus on in the remainder of my testimony, to emphasize why agriculture is adversely affected by the *Illinois Brick* decision.

As we have heard earlier today, agriculture is a highly competitive industry comprised of hundreds of thousands of geographically dispersed farmers. As a result, agriculture is the only large segment of our economy that is considered to be perfectly competitive.

Nonagricultural industries, on the other hand, have varying degrees of market power and, within limits, the capacity to adjust their prices. In short, a producer has little control over the prices he receives or the prices he pays.

If the input supply and output processing markets were also purely competitive in nature, the farmer would never be overcharged or underpaid. However, this simply is not the setting.

Instead, the perfectly competitive farmer is sandwiched between an imperfectly structured input market and an oligopsonistic output market. Given the farmer's unenviable position in the market, it is not surprising that agricultural producers are receiving a decreasing share of the consumer dollar.

Because of the varying degrees of oligopolies, a simple market model is difficult to develop. However, despite this analytical difficulty, two interrelated characteristics of oligopolistic pricing stand out.

On the one hand, oligopolistic prices tend to be inflexible or sticky; that is, these prices change less frequently in an oligopoly than they do under pure competition, and imperfect competition and, in some instances, pure monopoly.

On the other hand, when oligopolistic prices do change, firms are likely to change their prices together; that is, oligopolistic price behavior suggests the presence of incentives to act in concert or collusively in setting price changes.

Economists have shown that the ability of the direct purchaser to pass back a decrease product price, depends upon the relative elasticity of supply and demand. Unfortunately, this economic theory suggests, and business experience verifies, that price reduction by processors or distributors will be fully or largely passed back to farmers.

When supply is highly inelastic, as all farm products are in the short run, farmers will receive the full impact of the downstream price reductions.

If I could turn your attention for a moment to Attachment A of my testimony, we will find an example of this price reduction in the beef packing industry. Notice in Case 2, where the retailer decreases the price by 5 cents, that decrease will be passed on to the cattle rancher. In this scenario, the only loser is the rancher, since the retailer gains $30 and the packer comes out ahead $20.

This simply is one of the reasons why a packer is not concerned with the price manipulation of the retailer.

Because of the unique structures mentioned above, any anticompetitive practices are easily passed downstream to the producer, resulting in lower prices being paid to farmers, while the profits of food manufacturers and retailers continue to increase.

In the aggregate, these arguments show that farmers are likely to be victimized by price reductions that are caused by price-fixers, in the agricultural marketing system. Filure to permit farmers in these circumstances to sue, causes a grave injustice.

In summary, the National Grange believes that the ability to have State attorneys general act on behalf of the agricultural producer is an economic tool that is needed now. While we are not accusing anyone of price-fixing or market manipulation, the Grange feels that the farmer should have his day in court if the producer and the attorney qeneral agree that a violation has been committed.

In addition, this legislation will maintain the strict standards of proof under the procedures of antitrust litigation. No special legal advantage will be conferred upon plaintiffs as a result of the passage of S. 2481.

Once again, Mr. Chairman, I thank you on behalf of the National Grange and its members for allowing us to have this opportunity to express our support for the passage of this bill.

[The prepared statement follows:]

STATEMENT OF THE NATIONAL GRANGE
PRESENTED BY
MARK C. NESTLEN
LEGISLATIVE REPRESENTATIVE

I am Mark Nestlen, Legislative Representative of The National Grange, which has offices at 1616 "H" St., N.W., Washington, D.C.

The National Grange is a general farm organization that represents over 400,000 members in both farm and rural areas in 41 states. Since our beginning in 1867, The National Grange has been deeply involved with issues of national interest as well as with the special and vital interests of the agricultural economy.

Since its inception, the Grange has been truly concerned with the problems of monopolies and it has been a key figure in the passage of antitrust laws. The Granger movement signified the first major political effort to modify the outworn doctrines of complete *laissez-faire*. It initiated the radical but gradual revolution of American ideas, which ultimately brought large corporate enterprises under government regulation. The "anti-monopoly" and "reform" practices which first arose during the Granger movement exerted their direct effect upon the passage of the Granger Laws. According to Judge Thurman Arnold[1/], the Grange's influence on antitrust laws was more indirect than its influence on public utility legislation. However, he stated, "I have no doubt that without the Grange movement against monopoly, there would have been no Sherman Act."

It is with this in mind, Mr. Chairman, that I appear before you and your Committee today to testify on S. 2481, the "Antitrust Improvement Act of 1986." It is both a pleasure and an honor to appear before this Committee to express the Grange's support for a bill, whose passage is vital in retaining the family farm structure of agriculture. This bill, in part,

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[1/] Judge Arnold has had a long and distinguished career in antitrust legal affairs. From 1938 to 1943, he was Assistant U.S. Attorney-General in charge of antitrust actions From 1943 to 1945, he was Associate Justice, U.S. Court of Appeals, District of Columbia Circuit. He is the author of numerous books on the interrelationships of business, government and law.

will provide for indirect seller suits that are brought by State Attorneys General on behalf of farmers and ranchers who produce and sell agricultural products. This action is necessary due to the Supreme Court's decision in Illinois Brick.[2/] That decision prevents plaintiffs from establishing injury when that injury has been passed on to them as a result of an alleged antitrust violation. This ruling means that agricultural producers do not have standing to sue for damages that have been passed back to them as a result of anti-competitive activities of second and/or third handlers of their products. This decision unfairly affects farmers because it fails to recognize the unique competitive structure of the food and fiber system. It is this unique competitive structure that I will focus on during the remainder of my testimony to emphasize why agriculture is adversely affected by the Illinois Brick decision.

Agriculture is a highly competitive industry, comprised of hundreds of thousands of small, geographically dispersed producers. As a result, farmers have little control over the price at which they must sell their products. Agriculture is the only large segment of our economy that is considered to be perfectly competitive. Non-agricultural industries, on the other hand, have varying degrees of market power and, within limits, the capacity to adjust their prices. In short, the producer has little control over the prices they pay or the income they receive. If the input supply and output processing were also purely competitive in nature, farmers would never be overcharged or underpaid; however, this is not the setting. Instead, the perfectly competitive farmer is sandwiched between an imperfectly-structured input market and an oligoponistic (a few buyers dominate a market) output market. Given the farmers unenviable market position, it is not surprising that agricultural producers are receiving a decreasing share of the consumer dollar. Agriculture is the last stronghold of pure competition in an otherwise imperfectly competitive economy.

Let's briefly look at the two structures to show that agriculture is definitely purely competitive and the food distributing system is oligopolistic. First, when examining the four characteristics of pure competition, agriculture meets all four criteria. 1) By definition, a purely competitive industry is composed of a large number of independent sellers. 2) The firms offer a standardized product. This feature rules out non-price competition,

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[2/] Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

that is, advertising, sales promotion, and so forth. 3) No individual firm supplies enough of the product to influence its market price noticeably. 4) In a competitive industry, no artificial obstacles prevent new firms from entering, or existing firms from leaving the industry. Firms and the resources that they employ are shiftable, or mobile.

The major characteristic of oligopoly is "fewness". When a relatively small number of firms dominate the market for a good or a service, the industry is oligopolistic. There is strong evidence that shows that food manufacturers and retailers control the market. Seventy-five percent of the assets in the food manufacturing industry are controlled by the 100 largest food corporations. Because of this market concentration, the food processing industry is highly prone to collusive behavior.

The many breeds, or strains, of oligopoly preclude the development of any simple market model which provides a general explanation of oligopolistic behavior. However, despite the analytical difficulties, two interrelated characteristics of oligopolistic pricing stand out. On the one hand, oligopolistic prices tend to be inflexible, or "sticky". Prices change less frequently in an oligopoly than they do under pure competition, monopolistic competition, and in some instances, pure monopoly. On the other hand, when oligopolistic prices do change, firms are likely to change their prices together; that is, oligopolistic price behavior suggests the presence of incentives to act in concert or collusively in setting and changing prices. Collusive control over prices may permit oligopolists to reduce uncertainty, to increase profits, and perhaps to even prohibit the entry of new rivals. The market power enjoyed by food manufacturers has enabled them to increase their profit margins between $11 and $15 billion annually, an increase that reflects a level that is 25 percent higher than any other manufacturing industry during the same 1980-1983 period.

The Supreme Court felt that direct buyers and sellers are more capable of enforcing antitrust regulations than are indirect suppliers and purchasers. This is not true in the food industry. Several situations come to mind.

- Many agribusiness firms have established long-term, ongoing business relationships that discourage legal actions.
- Many food processors face powerful wholesale and retail buyers upon whom they depend for shelf space.
- Large food manufacturers and distributing conglomerates often tend to have a "live and let live" attitude in their buyer-seller relationships.

- In some cases, the affected parties may also be in independent violation of the law and are not willing to expose themselves.
- Affected businesses may not actually incur injury because of its ability to pass the lower price back to the farmer.

From the above examples, it is obvious that allowing only direct buyers and sellers to act as the enforcers of antitrust regulations is not as effective as including indirect suppliers in the "watchdog" process.

Consider the hypothetical example where grain elevators sell to traders who conspire to fix the purchase price of grain. We believe the elevator operators would simply pass back the lower prices to grain farmers. Under the *Illinois Brick* rule, however, only the grain elevator operators could sue for treble damages despite the fact that they were not damaged. The effect would be unjustly to enrich the elevator operators at the expense of farmers. If farmers were permitted to sue, they could demonstrate quite readily that the elevator operators "passed back" the lower prices to farmers. The same situation also exists in the livestock industry when meat packers pass back to farmers the lower prices they are paid by their customers. Not only is the short run supply of livestock very inelastic, but meat packers generally use the prices they receive for dressed meat at wholesale to determine the prices they pay for live animals.

Economists have shown that the ability of a direct purchaser to pass back an overcharge for a product depends upon the relative elasticities of supply and demand as well as on the institutional procedures used in establishing transfer prices. Without going into the details of the economic models demonstrating the significance of supply and demand elasticities, it is suffice to say that the damage allocation problem can become quite complex in some situations. Unfortunately, however, economic theory suggests - and business experience verifies that price reductions by downstream processors or distributors will be fully or largely passed back to farmers. When supply is highly inelastic, as is always true of farm products in the short run, farmers receive the full impact of downstream price reductions. Also, if an intermediary marketing industry is highly competitive, it will tend to pass back to farmers price decreases imposed on it.

Because of the unique structures mentioned above, any anti-competitive practices are easily passed downstream to the producer, resulting in lower prices being paid to farmers while the profits of food manufacturers and retailers continue to increase. Due to the highly inelastic nature of agricultural products, in the short run, farmers feel the full impact of downstream price reductions (See Attachment A).

The economic functions of the government are many, and they are varied. In fact, the economic role of government is so broad in scope that it is virtually impossible to establish an all-inclusive list of its economic functions. However, two major activities of government that are designed to strengthen and facilitate the operation of the price system are: 1) providing the legal foundation and social environment conducive to the effective operation of the price system; 2) maintaining competition. If Congress passes this legislation which allows the State Attorney General to act on behalf of the indirect injured farmer, the government will have further fulfilled their obligation.

In the aggregate, these arguments show that farmers are likely to be victimized by price reductions that are caused by price fixers in the agricultural marketing system. Failure to permit farmers to sue in these circumstances causes a grave injustice.

In summary, The National Grange believes that the ability to have State Attorneys General act on behalf of the agricultural producer is an economic tool that is needed now. While we are not accusing anyone of price fixing or market manipulation, the Grange feels that a farmer should "have his day in court" if the producer and the Attorney General feel that there has been a violation. In addition, this legislation will maintain the strict standards of proof under the procedures of antitrust litigation. No special legal advantages will be conferred upon plaintiffs as a result of the passage of S. 2481. Once again, Mr. Chairman, thank you for allowing The National Grange to express its support for this bill.

ATTACHMENT "A"

EXAMPLES OF THE EFFECTS OF PRICE FIXING

	RETAIL GROCERY STORES Retail Price of Meat		MEAT PACKERS Wholesale Price of Meat		FARMERS Farm Price of Cattle
CASE 1:	$ 2.50/lb. x 417 lb.*		$ .90/lb. X 600 lb.		$ .55/lb. x1000 lb.
	= $ 1042		= $ 540 + offal, hide, etc.		= $ 550
CASE 2:	Assume retailers fix lower price.				
	$ 2.50/lb. x 417 lb.	$-.05	$ .85/lb. x 600 lb.	$-.05	$ .50/lb. x 1000 lb.
	= $ 1042		= $ 510 + offal, hide, etc.		= $ 500
	retailer comes out $30 ahead		packer comes out $20 ahead		farmer comes out $50 behind

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*2.4 lb. of live cattle = 1 lb. of retail cuts.

Senator **Metzenbaum**. The Grange supports S. 2481?

Mr. **Nestlen**. Yes, sir.

Senator **Metzenbaum**. And, Mr. Carroll, you support S. 2481?

Mr. **Carroll**. Yes, sir.

Senator **Metzenbaum**. And, Mr. Connor, you support S. 2481?

Mr. **Connor**. I support it.

Senator **Metzenbaum**. All right, thank you.

Mr. Chairman, in the interests of time, and I know there are other witnesses, I have one question I think I will ask each of these gentlemen.

How can a conspiracy of retailers affect the price farmers or ranchers get for their products? In answering that, what is the extent of the effect? Is it a small amount or can it be significant?

Mr. Nestlen, do you want to answer that first?

Mr. **Nestlen**. Well, I will take the second part of your question first, Senator. As I know you gentlemen are all aware, the economy of the farm sector today—we spent many months recently arguing over things of that nature on how to help the farmer.

The extent of it is based on that. In today's economy, the slightest upset of the apple cart, as you might say, is going to run more of the small- and medium-size family farmers out of business.

Any decrease in the price they receive, as they are operating on a very slim margin right now, and many of them not even covering their variable costs—any decrease and we are going to wind up changing the structure of the family farm, of agriculture, and, in turn, rural America as a whole.

Senator **Metzenbaum**. Do you feel that if S. 2481 were to pass and be promptly implemented that it could help the family farmer during these very difficult times?

Mr. **Nestlen**. If one of the causes of these difficult times is price-fixing—and as I said in my statement, I am not in a position to sit here and convict any retailer or food manufacturer of price-fixing. But if that is one of the causes, this is an economic tool that the family farmer can use to stop that type of thing, to stop the reduced price being passed downstream because of the inelasticity of the agricultural product being a perishable product.

Yes, if that is a cause, this is a tool that is needed by the family farmer to keep him in business.

Senator **Metzenbaum**. Mr. Connor, would you care to add anything to what Mr. Nestlen has answered with respect to my question?

Mr. **Connor**. I think the question of how much farmers are affected is very much an empirical question. Meat wholesalers would be affected by that conspiracy because by raising prices at the retail level, the quantities passing through the wholesale level would be reduced and therefore their sales would be reduced. In addition, the wholesalers would probably receive a lower price for it.

The downward effect on prices would then go backward to the meat packers, and then back to the farmers. The effect would be probably somewhat diminished the further back through the chain you go, but there would be an impact on farmers—a negative impact on the price of fed cattle and eventually on feeder calves.

Senator **Metzenbaum**. I have no further questions, Mr. Chairman. Thank you very much.

The **Chairman** [presiding]. I might ask a question and any of you can answer it. As I understand it, you believe that this bill would make it more likely that any anticompetitive conduct by food manufacturing companies would be detected and remedied. Now, my question is why do you think it would be any easier for State attorneys general to prove conspiracies exist than for private parties.

Mr. **Carroll**. Is that my question, Senator?

The **Chairman**. I would be glad for any of you to answer it who would care to.

Mr. **Carroll**. The question was why would the State——

The **Chairman**. Why do you think it would be any easier for State attorneys general to prove conspiracies exist than for private parties?

Mr. **Carroll**. Well, I do not think that it would be any easier for the State attorney general to convict, but I think that what it would do would be to streamline the legal procedures so that some of the criticisms of changes in *Illinois Brick* would be countered by the fact that the State attorney general would have a handle on all of the legal procedures in his State.

Mr. **Nestlen**. Senator, if I could add to that, I do not think it is any easier for the State attorney general to prove this than a private party. As you will recall, during the farm bill debate, although that might not have been the proper place to put this, the Grange supported that amendment.

We would prefer that the individual farmer could bring suit rather than the attorney general, so that the private party could continue the private implementation of the antitrust laws as they were originally intended when passed.

However, with the concern of certain members of Congress, we are willing to compromise to the fact that we will allow the State attorney general to bring suit for the farmer, but we do not feel it will be any easier and if we had our druthers, yes, it would be the individual farmer that would bring the suit.

The **Chairman**. Mr. Nestlen, by the way, I have been a member of the Grange for 40 years. I paid the bills when they sent them; I reckon I paid them. If not, they have not sent me a bill. I think you have a fine organization.

Mr. **Nestlen**. Thank you, Senator.

The **Chairman**. Is it the position of the National Grange that the primary reason for low farm prices is conspiracy by the large grocery chains and food firms?

Mr. **Nestlen**. No, sir, in answering Mr. Metzenbaum's question—we simply believe that if this is happening that we need the tool to be able to investigate this, and if it is agreed that it is happening to stop it.

However, there are so many other factors that you are aware of that are affecting the low price of agricultural products which, in turn, cause the decreased net farm income. Simply, this is not the only reason.

The **Chairman**. I think that is all the questions I have.

Senator, do you have any more questions?

Senator **Metzenbaum**. None further. Thank you very much.

The **Chairman**. I want to thank you gentlemen for your appearance here.

Now, we will call the next panel: Judge Charles B. Renfrew, director and vice president, Chevron Corp., San Francisco, CA; James T. Halverson, Shearman and Sterling, New York, on behalf of the American Bar Association; Professor Edward Cavanagh, St. John's University School of Law, Jamaica, NY.

Mr. Halverson, I understand you have Ms. Kimball Wood, who has done considerable work on this subject.

Mr. HALVERSON. Yes, I do.

The CHAIRMAN. Would you like to have her sit by you? If so, Mr. Cavanagh, you could just move over one and let her sit by Mr. Halverson. I understand she is a good lawyer and you might need her to advise you.

Mr. HALVERSON. I need all the help I can get, Mr. Chairman. May I introduce Ms. Kimball Wood, who is a lawyer from New York and very active in the section of antitrust law.

Ms. WOOD. Good morning, sir.

The CHAIRMAN. All right. Judge Renfrew, I guess we will take you first. We are very pleased to have you here. You are quite an expert on these matters, and you may proceed now.

Senator METZENBAUM. Judge Renfrew, I do not think you were in the room when the chairman announced he had a 5-minute rule, and I think you were out of the room.

The CHAIRMAN. You have come a long way. We would like to restrict you to 5 minutes. If there is any particular reason that you have to go longer—and we will put your whole statements in the record—we would consider some exception, but I would like to keep it to 5 minutes, if I can.

STATEMENT OF A PANEL CONSISTING OF: CHARLES B. RENFREW, DIRECTOR AND VICE PRESIDENT, CHEVRON CORP., SAN FRANCISCO, CA; JAMES T. HALVERSON, SHEARMAN AND STERLING, NEW YORK, NY, ON BEHALF OF THE AMERICAN BAR ASSOCIATION, ACCOMPANIED BY KIMBALL WOOD, MEMBER, SECTION OF ANTITRUST LAW, AMERICAN BAR ASSOCIATION; AND EDWARD D. CAVANAGH, PROFESSOR OF LAW, ST. JOHN'S UNIVERSITY SCHOOL OF LAW, JAMAICA, NY

Mr. RENFREW. Thank you, Mr. Chairman. This issue has come before this committee before, and after I submitted my prepared statement I was curious as to its continued revival. I think the reason for it is that under the rule of *Illinois Brick*, there are two consequences that concern people deeply involved and committed to antitrust enforcement, such as Senator Metzenbaum.

These are that an indirect purchaser who may well have been injured by an antitrust violation is precluded from recovery, and the second is that a direct purchaser who may have passed on the entire overcharge is nevertheless permitted to recover the overcharge trebled for a windfall. I think that offends all of us as to our sense of justice.

Yet, though I sympathize with the reasons that the sponsors give for this legislation, I oppose it simply because I feel that it will impair the deterrent effect of the treble damage remedy and add to the complexity of antitrust trials, making them nearly impossible to try.

As to the deterrent effect, if only the direct purchaser is able to pursue the remedy, he has increased incentive to do so. The amount of his recovery is greater because it need not be shared with any indirect purchaser. The amount of the recovery is more certain because there is no need to allocate, and the trial is swifter.

In my experience as a trial judge, where there is a swift, sure remedy, there is greater deterrence, and I think this bears out our common sense, our knowledge of the facts. Before *Illinois Brick*, there were three times as many direct purchaser antitrust suits as there were indirect purchaser antitrust suits, and in almost every indirect purchaser suit there were also direct purchasers.

To eliminate the indirect purchaser does not mitigate this deterrent effect because the defendant is only liable for three times the damage that its violation has caused. The inclusion of the indirect purchaser does not add to the aggregate recovery; it simply changes its allocation.

Moreover, we know that the direct purchaser is closer to the scene, is more likely to be able to detect a violation, is more likely immediately hit by the violation, and more likely hurt by the violation.

As far as the complexity is concerned, the problems of proving the impact on the very levels of distribution are very great. As Mr. Justice White said, it requires massive evidence and complicated theories, making it almost impossible to try such cases.

Based on my experiences as a Federal district judge trying many antitrust cases, including multipanel district litigation, I feel that this would add to the complexity of such cases and make them very difficult to try.

I feel that the facially limited scope of this particular bill does not change these consequences. Every direct purchaser case, unless the direct purchaser is the ultimate consumer, raises the prospect of a case brought by the State attorneys general on behalf of indirect purchasers.

Now, the actions that are brought by the State attorneys general need not be brought on behalf of the State in its proprietary capacity, because the State and the Federal Government can enter into contracts with suppliers that the suppliers will assign them whatever rights they have against the manufacturers of goods. That has been done in a number of cases and been upheld in the courts.

As far as the ultimate consumer, which has to be the interest of this committee, there is in the legislative history of the parens patriae bill evidence that that bill was not contemplated to ensure recovery to the ultimate consumer.

Indeed, it is designated a civil penalty, and the legislative history made clear that it was contemplated that not all of the consumers—indeed, many would not get a recovery, but the recovery would be made for the benefit of the class of such consumers and for other public purposes.

In conclusion, Mr. Chairman, I oppose this legislation because I think it increases the costs and diffuses the benefits of the treble damage remedy, which is a very important weapon in antitrust enforcement.

Senator METZENBAUM. What was the second point? Increases the costs, and what else?

Mr. **Renfrew**. It diminishes the benefits of the treble damage remedy; diffuses those benefits, instead of concentrating them, Senator, in the direct purchaser.

That ends my statement, Mr. Chairman.

[The prepared statement and response to question follow:]

PREPARED TESTIMONY OF CHARLES B. RENFREW ON LEGISLATION WHICH WOULD REPEAL OR AMEND THE ILLINOIS BRICK and HANOVER SHOE RULINGS

My name is Charles B. Renfrew and I am a Director and Vice President, Law of Chevron Corporation. I am appearing here in opposition to legislation designed to alter the existing rules which permit only the first or "direct" purchaser in a chain of distribution to recover an antitrust overcharge. It is my belief that any effort to expand the potential number of plaintiffs to include subsequent or "indirect purchasers" would achieve very little by way of compensation and would vastly complicate and increase the cost of private treble damage litigation.

In Hanover Shoe v. United Shoe Machinery Corp. (1968) 392 U.S. 481, the Supreme Court held that the first purchaser in a chain of distribution is permitted to recover the full amount of an illegal overcharge arising from a violation of the Sherman Act, irrespective of whether that first purchaser was able to "pass on" some or all of the overcharge to its own customers. The Court relied on three policy considerations as the basis for this ruling. First, the problems of proof in trying to apportion an overcharge between levels of distribution "would normally prove insurmountable" (392 U.S. at 493). Second, any effort to apportion an overcharge between distribution levels would necessarily require "long and complicated proceedings involving massive evidence and complicated theories" (392 U.S. at 493). Third, to permit the "passing on" defense would dilute the incentives of first purchasers to initiate and prosecute private antitrust litigation (392 U.S. at 494).

The decision in Hanover Shoe dealt only with whether a defense based on "passing on" should be permitted against the first purchaser. The decision was silent on whether a subsequent purchaser, as a plaintiff, might be permitted to show offensively that an overcharge to the direct purchaser had been "passed on." In **Illinois Brick**

Co. v. Illinois (1977) 431 U.S. 720, the Supreme Court adopted the logical corollary to Hanover Shoe, holding that indirect or subsequent purchasers are equally precluded from proving "pass on." In deciding Illinois Brick, the Court relied on the same policy considerations that underlie the holding in Hanover Shoe, namely the impossibility of proving "pass on," the added complexity in attempting to do so, and the desirability as a policy matter of letting the first purchaser enjoy the full recovery.

The Illinois Brick decision has been highly controversial. Most people believe intuitively that if a direct purchaser is forced to pay an illegal overcharge, some or all of that overcharge is likely to find its way down to the next distribution level, and to whatever extent that occurs, the real injury to the direct purchaser is shifted to the indirect purchaser. There is little question that most businesses do attempt to recover their costs in the sale price of their products, and that a general prohibition against proof of "passing on" necessarily introduces some distortions into a system designed to compensate those injured by tortious behavior. In both the Hanover Shoe and Illinois Brick decisions, the Supreme Court recognized these distortions but considered them inescapable in the interest of judicial economy and in view of inherent limitations of the judicial process to deal with complex subject matter. The fundamental predicate of those two rulings is that the cost and inefficiency of proving the existence and amount of a "pass on," particularly when coupled with the procedural difficulties brought about by adding several layers of additional plaintiffs to every antitrust overcharge case, are prohibitive. In reaching this view, the Court relied heavily on an earlier ruling in Southern Pacific Co. v. Darnell-Taenzer Lumber Co. (1918) 245 U.S. 531 wherein a shipper was permitted to recover an overcharge by a common carrier, even though the overcharge had been "passed on" in the sale price of the goods shipped:

> "The general tendency of the law, in regard to damages at least, is not to go beyond the first step. As it does not attribute remote consequences to a defendant so it holds him liable if proximately the plaintiff has suffered a loss. The [shippers] suffered losses in the amount of the verdict when they paid [an overcharge]. Their claim accrued at once in the theory of the law and it does not inquire into later events . . . The carrier ought not to be allowed to retain his illegal profit, and the only one who can take it from him is the one that alone was in relation with him, and from whom the carrier took the sum . . . Probably in the end the public pays the damages in most cases of compensated torts" (245 U.S. at 533-534).

For nearly ten years and on numerous occasions, Congress has debated whether to rearrange the correlative rights and liabilities established by the decisions in Hanover Shoe and Illinois Brick.[1] On each of those occasions, Congress has concluded--albeit by inaction--first that the rule against proof of "passing on" reflects a workable and practical compromise which achieves rough justice, and second that the only real alternative would be so complex and costly as to be unworkable. In my view, Congress has wisely chosen to leave this compromise where the Supreme Court left it. Any lawyer or judge who has sat through the trial of a lengthy case quickly learns to appreciate the fragile nature of the judicial process itself and the inherent limitations of that process to deal accurately with complex or voluminous subject matter. Thus, while the Illinois Brick and Hanover Shoe decisions may be imperfect in that they fail to exactly correlate injury and compensation in every case, they represent about the best that we can expect of our judicial process. Certainly none of the legislative proposals to date has persuasively addressed the underlying policy considerations that motivated the decisions in Hanover Shoe and Illinois Brick.

Even without proof of "passing on," antitrust overcharge cases are already among the most difficult types of proceedings to be dealt with by the American judicial system. Starting with the filing of a complaint and sometimes continuing through a final appeal over an award of attorneys' fees, the time and energy devoted to motions, discovery disputes, disputes over attorney-client privileges, the interface between criminal and civil proceedings and a host of substantive legal issues exceed those for any other type of litigation.[2] Discovery in an overcharge case can run to millions of pages of documents; depositions can number in the hundreds or even thousands; and needless to say the cost can typically be measured in millions or tens of millions of dollars. The trial itself can take months or years of judicial time.

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[1] E.g., S.915, 98th Cong., 1st Sess. (1983); H.R.2244, 98th Cong., 1st Sess. (1983); S.2772, 97th Cong., 2d Sess. (1982); S.300, 96th Cong., 1st Sess. (1979); H.R.2060, 96th Cong., 1st Sess. (1979); S.1874, 95th Cong., 1st Sess. (1977).

This complexity will be significantly compounded if the trial court is also required to decide, in addition to all of the existing issues on liability and damages that attend an overcharge case, whether and in what proportions each of several levels of claimants are to share in the ultimate recovery. Trial of the "pass on" issue would add factual complexity, because by its very nature that issue is speculative and subject only to theoretical economic proofs. To determine whether an overcharge at one level of a chain of distribution had some effect at a lower level in the chain, the court would be required to assess and draw conclusions from such factors as the nature of the product and its manner of use, the form and mode of distribution, the nature of the market at each level, and the underlying economic conditions. It is difficult to overstate the problem of trying to draw hard factual conclusions from amorphous economic evidence of this type.

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[2] The recently published Manual for Complex Litigation (Second) is an outgrowth of the special procedures that were adopted nearly 50 years ago to deal with the large antitrust cases that began to proliferate during the 1940s and 1950s. See, e.g., "Procedures in Antitrust and Other Related Cases," September 1951, 13 F.R.D. 62; "Handbook of Recommended Procedures for the Trial of Protracted Cases," March 1960, 25 F.R.D. 351; Manual for Complex and Multi-District Litigation (1969).

Consider, for example, products which lose their identity when they are resold, because they are altered for or incorporated into the manufacture of some other product. In that situation, economic conditions in the market for the end product, along with labor and the cost of other materials and capital equipment used in the manufacturing process for the end product, may have far more to do with the price of the end product than does the acquisition cost of the component whose price was fixed. The Illinois Brick case itself illustrates the point. There the plaintiff State of Illinois had purchased buildings from general contractors, which in turn had contracted for masonry work performed by subcontractors, which in turn had purchased concrete block sold by the defendants on which the price was alleged to be fixed. At the direct purchaser or subcontractor level, numerous factors--over and above the price of the concrete block--would have influenced the price which the direct purchaser charged for the masonry work; labor, overhead and the immediate need to keep people employed are well-known factors which influence the price which a subcontractor may bid for work. For these reasons, it would be difficult to say with any certainty whether the eventual subcontract price would have been any different had the price of concrete block been lower by some amount.

The problem in Illinois Brick, however, was much more complicated than that, because the plaintiffs had not dealt with the masonry subcontractors. The prices paid by plaintiffs in that case were established in contracts with the general contractors, who had purchased masonry work as only a small part of a finished building. This, of course, introduced yet another set of economic factors which may have influenced the final price charged to the plaintiff, including many of the same economic considerations applicable to the subcontractors but in a different marketplace. It should be readily apparent to anyone concerned with accurately trying to determine the existence and amount of a "pass on" that any relationship between the final contract price paid by the plaintiffs in Illinois Brick and the original price of concrete block sold to the subcontractor is attenuated in the extreme, and more significantly, is impossible to discern. Furthermore, the tracing problem in Illinois Brick is probably simpler than in many other chains of distribution through which products and services pass in the real world. At some point, even the most ardent critics of the Illinois Brick rule are forced to admit that proof of further "passing on" becomes nothing but conjecture and speculation.

Even where the product whose price was fixed is an end product which is simply bought and resold, the analysis and presentation of the "pass on" issue will still be difficult or impossible. It is not enough to assume that a business will try to recover in its resale prices all costs of operation, including an overcharge in the acquisition price of products for sale or inventory. An equally important inquiry is whether the marketplace permits one level of purchaser to "pass on" overcharges to the next level in light of the competitive forces at work in both markets. The inquiry must consider, for example, whether competitors of the direct purchaser are themselves affected by the overcharge and perceive the opportunity for a price increase, whether the product itself is in competition with substitute products whose price was not fixed, the extent to which the entire industry for the product enjoys excess capacity to produce additional quantities of the product, and a host of other economic inquiries which vary from product to product, market to market and time to time. The Court in Hanover Shoe described the problem as follows:

> "A wide range of factors influence a company's pricing policies. Normally the impact of a single change in the relevant conditions cannot be measured after the fact; indeed a businessman may be unable to state whether, had one fact been different (a single supply less expensive, general economic conditions more buoyant, or the labor market tighter, for example), he would have chosen a different price. Equally difficult to determine, in the real economic world rather than an economist's hypothetical model, is what effect a change in a company's price will have on its total sales. Finally, costs per unit for a different

> volume of total sales are hard to estimate. Even if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined, there would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued. Since establishing the applicability of the passing-on defense would require a convincing showing of each of these virtually unascertainable figures, the task would normally prove insurmountable. On the other hand, it is not unlikely that if the existence of the defense is generally confirmed, antitrust defendants will frequently seek to establish its applicability. Treble-damage actions would often require additional long and complicated proceedings involving massive evidence and complicated theories" (392 U.S. at 492-493) (footnote omitted).

These inquiries are not only highly theoretical and speculative, they are also difficult and time consuming to prepare and present.

Perhaps more serious than the difficulty of trying to trace damages in the real world is the prospect of bringing before the trial court multiple claimants representing the various levels in a chain of distribution. Under the existing rules which permit only the first purchaser to recover, the plaintiffs in an overcharge case share relatively common interests, thus enabling the certification of class actions in many cases and enabling a relatively consistent presentation at trial. If the law were changed to permit multiple levels of claimants to pursue the same overcharge, these factors would no longer hold true.[3] Internecine struggles between the various levels of distribution would inevitably develop, as each level tried to enhance its share of the recovery at the expense of the other levels. The trial court may be required to resolve disputes among competing plaintiffs even over issues on which plaintiffs should be united, such as the underlying violation by the defendant, if evidence on those issues also relates to the "pass on" issues. At the very least, permitting multiple levels of claimants to seek the same overcharge promises to multiply, by a factor of two or three or more, the number of plaintiffs and plaintiffs' lawyers present in every proceeding. Once the door is opened to permit various levels of plaintiffs to prove a "pass on" of an overcharge, I think it is reasonable to expect that every overcharge case will attract seekers at many levels, just as every government proceeding for price fixing brought today attracts a private overcharge proceeding, almost without exception.

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[3] At the very least class certification would be more difficult. In _In Re Coordinated Pretrial Proceedings, Etc._ (C.D.Cal. 1981) 523 F.Supp. 116, affirmed (9 Cir. 1982) 691 F.2d 1335, the court refused to certify a class of consumers who allegedly paid inflated prices at retail gasoline stations as a result of an alleged conspiracy among the defendant major oil companies to fix the price of gasoline. The court was willing to accept, for argument purposes, that plaintiffs could bring their case within an exception to the rule in _Illinois Brick_, but the court considered a class action in that factual setting to be unmanageable. The court held that any theory on which plaintiffs might rely to prove "pass on" would raise predominantly individual questions relating to the relationships between each of the defendants and approximately 35,000 retail service station dealers.

Some proposals for repealing _Illinois_ _Brick_ have sought to avoid these procedural difficulties by leaving the _Hanover_ _Shoe_ rule intact, thereby permitting a plaintiff to show "passing on" of an overcharge for offensive purposes, but precluding any defense based on such a showing. The principal drawback with this approach is that it virtually assures that a defendant will be forced to pay multiple claims for the same overcharge, limited only by the willingness of the courts to tolerate speculative and theoretical proof of the "pass on" as products and services move from one level to the next. The Supreme Court in _Illinois_ _Brick_, as a preliminary to its analysis, carefully considered whether a consistent rule is necessary for both types of cases, and the Court determined that there is neither a practical nor an intellectually sound basis for treating them differently. The Court considered it inherently unfair to subject a defendant to multiple liability for the same overcharge (431 U.S. at 729-731). Further, the Court noted that both decisions are grounded, from a policy perspective, on exactly the same considerations, making it intellectually unsound to apply different rules to the offensive and defensive situations.

Senate bill S.2481 seeks to avoid these problems by permitting only state attorneys general to bring actions on behalf of indirect purchasers. In my view, S.2481 is no less subject than its various predecessors to the procedural and evidentiary shortcomings I have described. Irrespective of what the sponsors may intend, any procedure that permits both direct and indirect purchases in the same litigation will necessarily set into motion all of the undesirable litigation dynamics that Illinois Brick and Hanover Shoe sought to avoid. The bill clearly contemplates suits on behalf of more than one level of distribution.

In debating this subject, there has been considerable discussion of the impact which the Illinois Brick rule might have on the deterrent effect which is said to arise from private treble damage litigation and on the incentives of plaintiffs to pursue such litigation. Although I support the view that sound social purposes are served by maintaining sufficient incentives to encourage the discovery and prosecution of antitrust violations by "private attorneys general," I question whether we know much about what effects the twin decisions in Illinois Brick and Hanover Shoe have actually had on such litigation. Most of the discussion is oriented only in the present and fails to take into account the long-term effects which proof of "passing on" is likely to have on the incentives of both direct and indirect purchasers to pursue litigation. Thus when the various state attorneys general argue about the cases that might have been brought were it not for Illinois Brick, they do so having never been forced to deal with the need to prove a "pass on," the reduced incentives that go with having to subdivide a single recovery among numerous claimants, and the hazards of seeing the enormous expense of litigation go for naught because some prior plaintiff in the chain of distribution was able to persuade the trier of fact that the overcharge was never "passed on" to the level represented by those attorneys general.

In short, I do not believe that simply multiplying the number of potential plaintiffs necessarily increases the likelihood that violations will be discovered and prosecuted. It seems to me more likely that concentrating the full recovery at the first level will increase the overall incentive to sue. The purchaser closest to a violation is certainly in a better position to discover it, and the prospect of a full recovery unencumbered by having to share that recovery seems more likely to be worth the cost of litigation than would a situation where numerous claimants must be forced to fight over the recovery.

Proponents of overriding Illinois Brick sometimes argue that the indirect purchaser is more likely to pursue litigation than a direct purchaser, because he has no existing business relationships to protect. I question this, because I see no evidence that direct purchasers are at all timid about suing their suppliers. Numerous overcharge cases, both before and after Illinois Brick, have been brought by direct purchasers.[4] Furthermore, the class action device that has become popular in recent years takes away virtually any disincentive to sue that might arise from fear of upsetting existing business relationships, because it is the lawyers for the class, not the class members themselves, who are perceived as the plaintiffs.

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[4] For example, the Judicial Panel on Multi-district Litigation consolidated fourteen direct purchasers' treble damages actions against the manufacturers of fine paper, thirteen direct purchasers' treble damages actions against the five leading producers of industrial gas, and six direct purchasers' treble damages suits against the manufacturers of glassine and greaseproof paper (see In re Fine Paper Antitrust Litigation (E.D.Pa. 1979) 82 F.R.D. 143; In re Industrial Gas Antitrust Litigation (N.D.Ill. 1983) 100 F.R.D. 280; In re Glassine and Greaseproof Paper Antitrust (E.D.Pa. 1980) 88 F.R.D. 302).

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Charles B. Renfrew
Director and Vice President

June 13, 1986

Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Senator Thurmond:

This responds to your letter of June 3, 1986, and the question posed by Senator Specter. In my view, there is no inconsistency in permitting the end user of a product to sue the manufacturer over defects in that product while refusing to permit the same end user to sue for an illegal overcharge paid to the manufacturer by a middleman. In both instances, the judicial system is seeking to assess responsibility for the breach of a legal duty and to compensate the person or entity most directly injured by that breach. Any apparent discrepancy between the two results stems from fundamental differences in the nature of the injuries and the identity of the party most directly injured.

When the seller of goods or services fixes the price through conspiracy, the Hanover Shoe and Illinois Brick decisions establish what amounts to a presumption that any illegal overcharge will have at least some adverse impact upon the first purchaser, irrespective of whether the first purchaser is able to "pass on" some or all of that overcharge to subsequent levels of distribution. In part, this presumption is justified from the obvious fact that being forced to pay too much in and of itself is a form of injury, and in part because proof to the contrary is difficult or impossible. In any event, injury to the first purchaser is a basic prerequisite to the full recovery which the Hanover Shoe and Illinois Brick rulings accord him.*

In the product liability situation, by contrast, the first purchaser may be completely unaffected by the defects in the product which cause injury to the end user. If, for example, an end user has suffered bodily harm (or economic injury traceable to bodily harm) resulting from a defective product, that injury is unique to the end user and affects the middleman only indirectly through the loss of goodwill or the imposition of derivative liability, It is far more efficient in this circumstance to permit the end user to sue the manufacturer directly, and thus avoid or minimize a more elaborate multi-party proceeding which can reach the manufacturer only through an indemnity claim.

I hope the foregoing fully addresses your inquiry.

Yours very truly,

Charles B. Renfrew

Charles B. Renfrew

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* Indeed, both decisions recognize an exception for those situations in which it is easy to prove that the first purchaser was not injured by an overcharge, as for example when he buys pursuant to a "pre-existing cost plus contract" with his own customer (see, e.g., 392 U.S. at 494).

The CHAIRMAN. Thank you very much, Judge.

Mr. Halverson, we would be glad to hear from you or your lady adviser, or both.

STATEMENT OF JAMES T. HALVERSON

Mr. HALVERSON. Well, I will speak, Mr. Chairman, and then during the question and answer session, maybe Ms. Wood would like to say something, too.

Senator METZENBAUM. Mr. Halverson, before you speak, could I ask you a question?

Mr. HALVERSON. Yes.

Senator METZENBAUM. I have been here in the Senate a number of years and have previously chaired the Antitrust Subcommittee. The American Bar Association has normally come forward with pretty much of a balanced position, the plaintiff's position, the defendant's position, the corporate world position against the consumer position.

We have come to know you well up here, and I am wondering if you could tell us, perhaps in writing, what the makeup is of the Antitrust Subcommittee of the American Bar at the moment, and whether or not the members of that committee are predominantly defendants' lawyers or plaintiffs' lawyers. You have come up for S. 1300; you have been here for the President's bill on mergers; you have been here for cutting back on foreign companies in the antitrust cases.

I get the feeling that the American Bar does not have quite the same balance it used to have. I may be wrong; it may just be my perception. So I thought I would ask if you would furnish that information to us.

Mr. HALVERSON. I certainly will, Senator Metzenbaum. Let me just say in answer to that that the antitrust section of the American Bar has 13,000 members from all aspects of the bar, and we are doing a survey right now to find out which aspects of the bar they are from and we will supply that information.

But the position I am taking today and some of the prior positions were passed by the House of Delegates of the American Bar Association, which is some 450 in number and represents small bars, local bars all over the United States from every State and many, many small cities.

My experience, having served in the House of Delegates, is there are many plaintiffs' lawyers there.

Senator METZENBAUM. The House of Delegates took this position before I introduced the bill?

Mr. HALVERSON. No. The House of Delegates is on record in 1984 against any legislative repeal of the combination of *Hanover Shoe* and *Illinois Brick* because of the implications which I will discuss in a minute

Senator METZENBAUM. All right. I would just ask the timekeeper not to charge him with the time.

The CHAIRMAN. Sure.

Does that include plaintiffs' lawyers, too, who happen to be members?

Mr. HALVERSON. Oh, absolutely. The House of Delegates has plaintiffs' lawyers from all over the country.

The CHAIRMAN. I just wanted to be sure it represented a fair cross-section.

Mr. HALVERSON. Absolutely. In fact, the smaller bars tend to have more plaintiffs' lawyers than defense lawyers.

The CHAIRMAN. You may proceed, Mr. Halverson.

Mr. HALVERSON. Well, I do not want to take much of the committee's time. We have been here before as the American Bar Association, and I believe Ms. Wood testified last time. We did a very careful study of this whole problem, and we think a balanced study, Senator Metzenbaum, which I will describe in a minute.

We are very concerned about any repeal, including the proposed S. 2481, because it does not reach the problems identified by the Supreme Court in *Illinois Brick*; that is, the overcomplicated money damage recovery determinations, the unwieldy nature of investigations to trace overcharges, and the dilution effect which Judge Renfrew referred to.

It dilutes the possibility of recovery for each individual claimant to the extent that it may, in fact, dilute the incentive to sue under private treble damage situations.

Senator METZENBAUM. Are you really concerned about that?

Mr. HALVERSON. Well, I am concerned that——

Senator METZENBAUM. You know, I must say that I sit here with tongue in cheek when I think of you and Mr. Renfrew being here indicating a concern about the right of the plaintiff to sue, and I say methinks he doth protest too much.

Mr. HALVERSON. Well, I am a defense lawyer, Senator Metzenbaum.

Senator METZENBAUM. I know that.

Mr. HALVERSON. That has been my life, and you know that.

Senator METZENBAUM. I respect you for that.

Mr. HALVERSON. But I also represent other lawyers who voted on this position who are plaintiffs' lawyers, and our committee is pretty well balanced and I will submit that for the record. I have to speak, as you know, from both respects.

I do recognize the strong possibility of dilution here, dilution of any individual claimant's amount of recovery, and I will get to the study we did in a minute which shows that direct purchaser suits did not decline after *Illinois Brick*. In fact, they stayed about the same—77 percent before and 78 percent after of private claimant suits following on governmental criminal prosecutions.

That study was very carefully done, and the Justice Department did a similar study and reached the same conclusion. Now, if the direct purchaser has the greatest opportunity and the greatest incentive to bring suit and is still doing so, at least in the period we studied, which was 1977 to 1982, then, with great respect, Senator Metzenbaum, I would say let us leave the system alone because the complexity and cost of trying to trace overcharges through several levels of distribution would be great.

Senator METZENBAUM. If we were to leave the system alone with respect to *Illinois Brick*, would you be willing to leave the system alone with respect to S. 1300 and some of the other bills that are vitiating the effectiveness of antitrust legislation in this country?

Do you think we ought to leave all antitrust legislation alone?

Mr. HALVERSON. I think S. 1300 would clear up an inequity that has long been there, so I supported that.

Senator METZENBAUM. I know you did. Go right ahead; do not let me interrupt you.

Mr. HALVERSON. That concludes my statement, Mr. Chairman.

[The prepared statement follows:]

STATEMENT

of

JAMES T. HALVERSON, CHAIRMAN

SECTION OF ANTITRUST LAW

AMERICAN BAR ASSOCIATION

Mr. Chairman and members of the Committee, my name is James T. Halverson, and I am Chairman of the Section of Antitrust Law of the American Bar Association. I am appearing before the Committee today on behalf of the American Bar Association. By a resolution passed in 1984, the American Bar Association is on record opposing repeal, either in whole or in part, of the Supreme Court's decisions in _Hanover Shoe, Inc., v. United Shoe Machinery Corp._, 392 U.S. 481 (1968), and _Illinois Brick Co. V. Illinois_, 431 U.S. 721 (1977).

S. 2481, being considered today, would provide for a limited repeal of _Illinois Brick_ by permitting state attorneys general to bring antitrust actions as _parens patriae_ on behalf of indirect purchasers, and in some cases, indirect sellers. The ABA opposes such legislation because it would permit indirect purchaser suits without solving the problems identified by the Supreme Court in _Illinois Brick_. According to that decision, allowing suits by indirect purchasers could dilute the deterrent effect of antitrust damage recoveries, overcomplicate money damage proceedings, introduce unwieldy investigations to trace overcharges throughout a chain of distribution, and open up the possibility of multiple recoveries and inconsistent judgments.

The _Hanover Shoe_ and _Illinois Brick_ decisions were premised on these inescapable and very real practical problems, inherent in indirect purchaser suits. For the most part, these problems are related, not to the identity of the individual bringing the suit, but instead to the type of injury that is alleged and the remoteness of the injured parties from the defendant. The Official Reporter succinctly summarized these concerns of the _Illinois Brick_ Court:

> "[w]hole new dimensions of complexity would be added to treble-damages suits, undermining their effectiveness, if the use of pass-on theories under § 4 were allowed. Even under the optimistic assumption that joinder of potential plaintiffs would deal satisfactorily with problems of multiple litigations and liability, § 4 actions would be transformed into massive multiparty litigations involving many distribution levels and including large classes of ultimate consumers remote from the defendant. The Court's concern in Hanover Shoe with the problems of 'massive evidence and complicated theories' involved in attempting to establish a pass-on defense against a direct purchaser applies *a fortiori* to the attempt to trace the effect of the overcharge through each step in the distribution chain from the direct purchasers to the ultimate consumer." 431 U.S. at 721.

The proposed bill would merely elevate *parens patriae* claims over other indirect purchaser claims while ignoring the problems which the Supreme Court found so troublesome in Illinois Brick and Hanover Shoe. For example, the legislation does not address the Court's concern that tracing the absorption of overcharges through the chain of distribution would render antitrust actions so complex and costly that their effectiveness would be hindered. An example of such problems may be instructive. In Philadelphia Housing Authority v. American Radiator & Standard Corp., 50 F.R.D. 13 (E.D. Pa. 1970), *aff'd sub nom.* Mangano v. American Radiator & Standard Corp., 438 F. 2d 1187 (3d Cir. 1971), plaintiffs consisted of groups of purchasers at four distinct points in a distribution line--plumbing contractors, general building contractors, new home buyers, and used home buyers. The court found untenable the plaintiff's contention that a builder selling a $30,000 house would have priced the house at $29,990 but for a $10 overcharge imposed by the defendant plumbing fixtures manufacturers, rather than basing his pricing decision on the demand in the market for homes as a whole. The Illinois Brick Court, too, noted that "[o]vercharged direct purchasers often sell in imperfectly competitive markets. They often compete with other sellers that have not been subject to the overcharge; and their pricing policies often cannot be explained solely by the convenient assumption of profit maximization." 431 U.S. at 742.

Manageability problems under the proposed legislation would also result from the increased numbers of parties. The result of the consolidation, joinder, intervention, and burden of proof provisions of S. 2481 will necessarily result in complex multiparty actions, because the defendant will feel compelled to join all potentially overcharged parties. The consequence of introducing such increased complexity into antitrust litigation may be illustrated by the decision in In re Antibiotics Antitrust Actions, 1976-2 Trade Cas. (CCH) ¶ 61,058 (D. Minn. 1976), where after seven months of actual trial time over the course of one and one-half years, in which 136 volumes of trial testimony had accumulated, much of it extraneous to the issues remaining in the case following the numerous settlements, Judge Miles Lord declared a mistrial, stating that it would be impossible for the jury to reach a fair verdict based on the evidence relevant to the claims remaining in the case. The length of the trial, occasioned in large part by the number of parties, was a major ground upon which the court relied in granting the defendants' mistrial motion.

The Illinois Brick decision was delivered in an extremely thoughtful and persuasive opinion by Justice White. The ABA finds its reasoning as compelling today as it was in 1977, and I have therefore appended the majority opinion to my testimony as Appendix A. Pages 737 through 744 are particularly instructive on the problems inherent in the offensive use of pass-on.

In a 1977 statement before the Subcommittee on Monopolies and Commercial Law of the House Judiciary Committee (Comments on H.R. 8359, 95th Cong., 1st Sess. at 502-505), the Committee on Trade Regulation of the Association of the Bar of the City of New York noted yet another aspect of the damages issue that would result from a reversal of Illinois Brick. This is the so-called "multiplier effect." Economic analysis conducted by that Committee made clear that whenever an illegal overcharge is added to the cost of an item at any level, and subsequent levels mark up their cost by a resale percentage (to recover their cost and some expected profit), then the original overcharge will be amplified to potentially huge amounts. The ultimate amplification would depend on how many levels of pass-on are involved, as well as the ability to mark up costs in the particular competitive environment at each level. The results can be damages assessed against a defendant at anywhere from two to six times the original overcharge, depending on how much of the overcharge is absorbed at each level.

While the multiplier effect's magnitude for the end consumer might be lessened by competitive absorption of overcharges at some levels, the principle remains that a relatively small overcharge can be magnified to far higher resulting amounts than those charged by the original seller. The increased amounts result from the working of multilevel distribution chains rather than from the unlawful acts of defendants. If threefold recovery is an option for indirectly injured antitrust plaintiffs, the multiplier effect may cause the potential recovery to reach far beyond treble the original overcharge. Unfortunately, the proponents of a even a partial reversal of Illinois Brick and Hanover Shoe, including S. 2481, do not present a solution to the multiplier effect.

Senator Metzenbaum, in introducing S. 2481, stated that the bill provides "rules" for allocating damages and special procedures to prevent multiple recovery. He refers to Section 3 of the bill, which would create subsections (e)(1)(A)-(C), (2)(A)-(C), (3) and (4) of Section 4C of the Clayton Act. These subsections are all procedural in nature and provide general direction as to how claims should be allocated as among direct and indirect purchasers, and as to burden of proof in establishing overcharges or underpayments. They do nothing, however, to provide a method of calculating damages at any given tier in the distribution chain. As noted above, that has been the problem inherent in indirect purchaser suits all along. The complexity of these calculations is nowhere addressed or even acknowledged by S. 2481.

Thus, if a change is to be made, it is the opinion of the ABA that this is not the way to do it. However, a larger question is whether any change is called for at all. There has been considerable speculation concerning whether the Supreme Court was correct in assuming, in both Hanover Shoe and Illinois Brick, that the antitrust laws will be enforced most effectively by permitting direct purchasers to recover the full amount of any overcharge, rather than by apportioning the overcharge among direct and indirect purchasers. The principal challenge to this assumption has come from those who believe that direct purchasers will not sue their sellers, either because they are too closely aligned in interest with them or because they fear retaliation. See, e.g., Cong. Rec., March 22, 1983, H.R. 1549 (comments of Mr. Rodino).

Because there was little empirical data available showing whether direct purchasers had been deterred from suing after Illinois Brick, a Section of Antitrust Law task force undertook a study to determine the extent to which direct purchasers had sued their sellers for antitrust violations both before and after Illinois Brick. Although the task force was unable to obtain complete statistical information concerning the incidence of direct purchaser actions, the survey results show that direct purchasers do sue, irrespective of ongoing supplier relationships, and that these suits are sufficiently common that the threat of suit remains a deterrent. I have appended to this testimony the survey materials and charted results, which were tabulated pro bono by National Economic Research Associates, Inc., as Appendix B. The survey covered the years 1975-1982. Since the Department of Justice had brought a number of cases involving bid rigging on highway construction projects [where there is rarely a private party with standing to sue] from 1980 on, those cases were tabulated separately. This made it possible, using comparable case data, to examine whether governmental direct purchasers sued less frequently after the

Supreme Court's Illinois Brick decision.

One result noted on the charts is that there was a direct purchaser action or settlement after the filing of a government case in 77% of cases for which information was obtained prior to Illinois Brick, and a similar action in 78% of cases for which information was obtained after Illinois Brick. The survey results further indicated that in most of the cases where there was no follow-on litigation, the defendants may have had minimal assets.

In sum, the Supreme Court's decision in Illinois Brick was based on valid concerns regarding unduly complex proof of injury and damages, virtually insoluble procedural difficulties, and potential multiple liability. To the extent that currently proposed legislation would permit certain indirect purchaser claims, the ABA believe that it does not provide satisfactory solutions to those concerns, and is likely to produce results contrary to those intended by Congress.

Mr. Chairman, I thank you for the opportunity to present the views of the American Bar Association on this matter.

The CHAIRMAN. Thank you very much.
Mr. Cavanagh.

STATEMENT OF PROF. EDWARD D. CAVANAGH

Mr. CAVANAGH. Thank you, Mr. Chairman. I appreciate the opportunity to be heard today on the proposed legislation, S. 2481. I am currently a professor of law at St. John's University School of Law in New York City, but I would like to emphasize today that my remarks reflect my personal views and do not necessarily reflect any views of my institution or any professional organization to which I belong.

I have submitted a written statement and ask that that be made part of the record.

I would just briefly like to comment on the bill and to respond to several remarks that were made today. First, I agree with Judge Renfrew that *Illinois Brick* is perhaps——

The CHAIRMAN. Speak in your loud speaker so we can hear you.

Mr. CAVANAGH. I agree with Judge Renfrew that *Illinois Brick* is perhaps not an ideal solution to the problems of indirect purchaser suits. Nevertheless, it does confront the very real practical difficulties that arise in the management of complex litigation, and it does attempt to strike a fair balance between the often competing goals of compensation and deterrence.

I think its accommodation of these competing interests will ultimately promote rather than deter antitrust enforcement.

This bill does attempt to deal with the potential problems of multiple liability and inconsistent judgments through a compulsory joinder mechanism. However, I seriously doubt whether competing claims of direct and indirect purchasers can be resolved in the same case without possibly sacrificing the due process rights of all the litigants.

Second, I think it is a mistake to overrule even in part the *Hanover Shoe* decision. *Hanover Shoe* is a plaintiff's case. To the extent that passing-on is made a viable defense, I have little doubt that the defense bar will raise it at every opportunity and tie the plaintiffs up in knots in the process, and I think that would frustrate the basic purpose of this legislation.

I think allowing the passing-on defense is simply too high a price to pay for permitting claims on behalf of indirect purchasers.

Third, I think that the *Illinois Brick* decisions seems to have become something of a scapegoat for a whole range of societal ills. It has been blamed for the decline in antitrust enforcement. It seems to be being blamed for State and local fiscal crises, as well as the farm problem.

It seems to me that a number of factors have contributed to the decline of antitrust enforcement in recent years, and a significant contributing factor has been the striking lack of enforcement at the Federal level.

The Antitrust Division has chosen to devote its resources to prosecuting a rather narrow spectrum of bid-rigging cases. These are the cases which very rarely give rise to private follow-on litigation.

In this sense, I think to an extent the Federal Government has abdicated its traditional leadership role in antitrust enforcement.

The private bar needs the Antitrust Division out there bringing cases in order to make it feasible for private enforcement activities.

In addition, there are several other reasons, I think, for the decline in antitrust enforcement, including some substantive law developments—the *Sylvania* decision, making it very difficult for plaintiffs to recover in distribution cases; the *Brunswick* case on antitrust injury; and I think most recently the *Matsushita* case, which makes the standard for summary judgment somewhat more lenient for defendants.

Finally, I note that this bill would also overrule in part the Fifth Circuit decision in the *Beef* cases by permitting State attorneys general to bring claims on behalf of agricultural sellers.

I see no basis for singling out agricultural cases for special treatment. Moreover, I think this provision would extend Hart-Scott-Rodino beyond its original limit. Originally, Hart-Scott-Rodino, as I understand it, was designed to protect consumers and natural persons. This bill would be protecting agricultural sellers who are neither consumers nor, in many cases, natural persons.

That is all I have to say, Mr. Chairman. Thank you very much.

[The prepared statement and response to question follow:]

STATEMENT OF EDWARD D. CAVANAGH, PROFESSOR OF LAW, ST. JOHN'S UNIVERSITY SCHOOL OF LAW, BEFORE THE SENATE COMMITTEE ON THE JUDICIARY, JUNE 3, 1986

I appreciate the opportunity to be heard on the proposed legislation, which is designed to overrule in part the Supreme Court decisions in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977) and *Hanover Shoe Corp. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968).

I am currently Professor of Law at St. John's University School of Law in New York City where I have taught since 1982. For nearly eight years prior to that, I was engaged in the private practice of law, concentrating in antitrust litigation. I have also written in the antitrust field specifically on issues relating to the *Illinois Brick* decision. While I am a member of a number of professional organizations, the views which I express here today are my own and do not necessarily reflect the positions of any professional group to which I belong nor the institution with which I am affiliated.

Nearly three years ago, on June 8, 1983, I testified before this Committee on a similar bill, S.915, and at that time stated that S.915 was fraught with practical pitfalls which would create insurmountable hurdles to fair and effective management of antitrust cases, thereby frustrating the twin aims of treble damage litigation — deterrence and compensation. I reiterate that view today. Indirect purchaser claims are inherently complex, raise novel and difficult problems of proof, present serious risks of multiple liability and place staggering burdens on the courts and the litigants. The enormous procedural and practical problems engendered by the complex issues which are inherent in major antitrust treble damage litigation are best handled by the courts which are in a better position to determine which claims are meritorious and which are brought primarily for the benefit of attorneys. Legislative intrusion into the passing-on domain may have a result quite opposite from that intended by Congress by creating a procedural quagmire of competing and speculative damage claims which, in the end, will make it even more difficult for all plaintiffs to be compensated for antitrust violations.

My views on *Illinois Brick* are set forth in detail in an article published two years ago. See Cavanagh, *The Illinois Brick Dilemma: Is There A Legislative Solution?*, 54 Albany L. Rev. 273 (1984). Today, I wish briefly to make four points: (1) *Illinois Brick* was properly decided; (2) permitting proof of passing-on would create insurmountable problems of manageability and impose enormous costs on the judicial system and the litigants; (3) any modification of the *Hanover Shoe* holding to permit the passing-on defense would have potentially disastrous effects on antitrust enforcement; and (4) this bill is not the solution to the current problem of declining antitrust enforcement.

I. ILLINOIS BRICK WAS PROPERLY DECIDED AND OUGHT NOT TO BE OVERRULED BY CONGRESS.

The Supreme Court in Illinois Brick, reaffirming its prior holding in Hanover Shoe, held that the overcharged direct purchaser, and not indirect purchasers down the distribution line, is the party "injured" in its business or property under § 4 of the Clayton Act and should be deemed to have suffered the full measure of damage caused by any illegal overcharges. Thus, Illinois Brick precludes recovery by indirect purchasers in treble damages actions actions who claim to have had illegal overcharges passed on to them by their sellers and thus to have borne the brunt of such overcharges.

Illinois Brick has not been a popular decision in many quarters. Although we can probably all agree that the antitrust laws ought to be enforced so as to maximize the twin goals of compensation and deterrence, there is considerable disagreement as to how these goals might best be accomplished in the real world. As a general proposition, I find it difficult to quarrel with the position that persons who may have been injured by antitrust violations are entitled to their day in court. Nevertheless, I am not convinced that we can compensate all indirect purchasers who may have absorbed part of an overcharge without seriously imperiling the deterrent value of the treble damages remedy. Where the administrative and social costs of enforcing indirect purchasers' claims in terms of (1) lengthier and more expensive pretrial and trial proceedings; (2) more complicated proof; (3) unwieldy trials; (4) clogged dockets and (5) diversion of benefits from victims to lawyers outweigh the benefits derived therefrom, the aims of antitrust enforcement, especially in terms of deterrence, are not furthered but rather hindered.

While Illinois Brick is perhaps not an ideal solution to the problems posed by indirect purchaser suits, it does confront face to face the very practical difficulties which arise in the litigation and management of complex antitrust suits. The decision strikes a fair balance between the often competing goals of compensation and deterrence, and its accommodation of these competing interests will ultimately promote antitrust enforcement.

Thus, Illinois Brick cannot be fairly viewed as an anticonsumer decision. The decision itself does not bar consumers from suing for treble damages; consumers may recover under Illinois Brick if they can prove that they purchased directly from the defendants. What Illinois Brick has done is to bring some semblance of order to the chaos which had prevailed prior to that decision in indirect purchaser actions where plaintiffs claimed to have been injured by overcharges passed on to them by intermediaries.

It seems to me that the proponents of the current bill and its predecessors dating back to 1977 brush aside the practical problems which inevitably arise in complicated antitrust litigation, suggesting that they are more imaginary than real. In my view, the practical problems identified by the majority in Illinois Brick are very real and in no way overstated. The problems include: (1) difficulties in tracing alleged overcharges from point to point through the chain of distribution, especially in recreating the price/output decisions of thousands, if not hundreds of thousands, of non-party intermediaries and allocating injury between direct and indirect purchasers; (2) the added dimension of complexity which passing-on will being to already complicated lawsuits which threatens to render antitrust cases wholly unmanageable; (3) the risks of multiple liability and inconsistent judgments which arise by sanctioning suits by indirect purchaser suits; and (4) reduction in the effectiveness of the treble damages remedy which would result from the combination of increasing costs and diffusing benefits, were indirect purchasers, with a relatively small stake in the outcome, permitted to sue.

Unfortunately, the pending bill fails effectively to address or to resolve the manageability problems inherent in indirect purchaser actions as described in Illinois Brick. The legislation simply singles out a class of cases — parens patriae cases pursuant to 15 U.S.C. § 15c — in which offensive and defensive use of passing-on will be permitted. However, there is nothing about the parens patriae cases as a class which logically differentiates them from the run-of-the-mill indirect purchaser cases. Indeed, the bill presents precisely the kinds of enormous practical problems — manageability, tracing, complexity, and skyrocketing costs — which hinder rather than promote enforcement of the antitrust laws.

II. PERMITTING PROOF OF PASSING-ON WOULD CREATE INSURMOUNTABLE PROBLEMS OF MANAGEABILITY AND IMPOSE ENORMOUS COSTS ON THE JUDICIAL SYSTEM AS WELL AS THE LITIGANTS

A. Tracing Overcharges

A major practical problem created by allowing proof of passing-on is tracing the overcharge from the alleged antitrust violator through the various intermediaries in the chain of distribution to the plaintiff-indirect purchaser. Tracing involves two interrelated exercises: (a) flagging the alleged overcharge from transaction to transaction in the vertical distribution chain; and (b) establishing a causal nexus between an overcharge so identified and the defendants' purported illegal conduct. I do not believe that either of these tasks can be accomplished in the courtroom without resort to outright guesswork.

In the usual price-fixing cases involving plaintiffs who are direct purchasers, the measure of damages is the difference between the price actually paid by the plaintiff and the price that would have been paid but for the claimed overcharge. Determining the "but for" price is frequently complicated under present law but would be made even more complicated were the proposed legislation enacted.

Indirect purchasers' claims would be measured by the difference between what indirect purchasers actually paid for the particular goods and what the price of the wholesaler, retailer or other middlemen would have been but for the manufacturer's illegal overcharge. The key issue in indirect purchaser claims is not whether intermediaries generally pass-on increments or decrements in their acquisition costs, but rather the extent they would have done so in particular transactions had their acquisition costs not been inflated by illegal overcharges. Resolution of the passing-on issue thus requires the court to re-create the price/output decisions of nonconspiring resellers, including whether each reseller would have realized more on its resale had one element of cost been lower, whether such reseller would have kept its resale price the same, had its costs been less; and whether such reseller would have lowered its price in the amount of the reduced acquisition costs.

Tracing may seem like a fairly easy exercise when looking at a "laboratory model" consisting of a conspiracy at the manufacturer's level with several manufacturers selling to retailers who in turn sell to the consumer. However, the exercise becomes mind boggling when one attempts to trace overcharges in the real economic world involving numerous levels in the distribution chain, consisting of hundreds of wholesalers, thousands of retailers and millions of consumers. Moreover, the price/outpout decisions of intermediaries at each point in the distribution chain must be examined to measure accurately the precise amount passed on. Thus, adjudication of the passing-on claims would force the court to examine individual relationships between intermediaries and defendants thereby splintering the action into thousands of individual trials requiring years to litigate. Such a litigation is clearly unmanageable.

B. Complexity

The judicial system is simply not equipped to handle the massive evidence which would become part of every antitrust treble damages action were proof of passing-on permitted. Introduction into evidence of what the price/output decisions of manufacturers and middlemen at various points in the distribution chain would have been but for the overcharge, furnished primarily by expert economists, threatens to transform the court room into a three-ring circus. In the case of a nationwide conspiracy, the fact-finder will be subjected to testimonial and documentary evidence regarding the individual pricing decisions of hundreds of wholesalers and perhaps thousands of retailers on millions of transactions. Trails would become interminable and pretrial discovery would become lengthier, costlier and more detailed. I do not think that the federal courts can embark on such massive undertakings without either running roughshod over the rights of the parties or forcing our already overtaxed judicial system to collapse.

The task of sorting out the rights of direct and indirect purchasers would be a formidable one for a trial judge well-schooled in esoteric antitrust damage principles, but it may well prove an insurmountable task for a jury. The Committee should not assume that plaintiffs or defendants will waive their Constitutional right to a jury trial in parens patriae cases. The bill makes no proposal as to how the claims of all parties can be fairly and effectively adjudicated in the context of a jury trial without risking sacrifice of each party's due process rights.

III. THE ANTITRUST LAWS WILL BE MOST EFFECTIVELY ENFORCED IF FULL RECOVERY IS LODGED IN THE HANDS OF FIRST PURCHASERS

I think Hanover Shoe was correct in holding that the first purchaser is the person injured in its business or property within the meaning of § 4 of the Clayton Act. A direct purchaser is in the best position to detect a violation. Since the direct purchaser deals directly with the alleged violator and presumably the violator's competitors, it is in a better position than remote purchasers to determine whether price increments are due to conspiracy or due to a legitimate cause. Moreover, since direct purchasers, unlike indirect purchasers, are not saddled with the burden of proving passing-on, the direct purchaser incurs far less costs in proving its claims. In my view, it would be disastrous for antitrust enforcement and particularly for plaintiffs to overrule Hanover Shoe by permitting the passing-on defense. The passing-on defense will most likely be raised in every case. Direct and indirect purchasers will be forced to waste their typically limited resources in competing with one another to prove how much of an overcharge was or was not passed-on, instead of focusing on defendants' violation of the antitrust laws. Given the uncertainty of the amount of any recovery because of the passing-on defense, even in the face of clear liability, direct purchasers will be discouraged from suing. Defendants will have greater incentive to engage in delay tactics and will vastly expand the scope of discovery. In short, re-introduction of the passing-on defense will make it much more difficult for plaintiffs to recover in treble damages actions and thereby hinder enforcement of the antitrust laws.

IV. THE PROPOSED BILL IS AN ILL-ADVISED SOLUTION TO THE PERCEIVED PROBLEM OF DECLINING ANTITRUST ENFORCEMENT

I share the concern of proponents of this bill over declining antitrust enforcement in the federal system. However, I think it is a mistake to hold the Illinois Brick decision responsible for all the present woes of antitrust enforcement. For this Committee to assume that Illinois Brick is the principal factor or even a significant causal factor in this decline in antitrust enforcement is a dangerous exercise in post hoc ergo propter hoc reasoning. I know of no empirical studies which support contentions that direct purchasers who are victims of antitrust violations are reluctant to sue violators for fear of disrupting business relationships. Indeed, the available data seems to indicate that direct purchasers do, in fact, sue. See Report Of The Antitrust Section's Task Force to Review Proposed Legislation to Repeal Or Modify Illinois Brick, 52 Antitrust L. J. 841, 863-65 (1984).

In my view, a number of factors have contributed to the decline of private suits but perhaps the most important factor is the striking lack of enforcement activity — outside the road building and government contracting areas — by the Antitrust Division. In concentrating its resources on hard-core price-fixing in the bid rigging area, the Division has indeed uncovered a wealth of illegal activities. However, little is left over to fund investigation and detection of other types of antitrust violations. Enforcement in the vertical area is virtually non-existent; nor has the Division in recent years attempted to pursue novel theories of liability. More importantly, the types of cases now being pursued by the Division rarely give rise to follow-on suits by private parties. The private antitrust bar has traditionally looked to the federal government for leadership in detecting and prosecuting violations. Without prior government activity, private parties simply cannot afford to undertake the costs and risks of an antitrust action.

Secondly, changes in the substantive law have made it more difficult for plaintiffs to recover. Courts have gradually moved away from the application of per se rules. For example, under Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), most non-price vertical restraints are now subject to a rule of reason analysis. See also Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 105 S. Ct. 2613 (1985); National Collegiate Athletic Association v. Board of Regents of the University of Oklahoma, 104 S. Ct. 2948 (1984). Similarly the doctrine of antitrust injury enunciated in Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U. S. 477 (1977) has made the plaintiffs' burden heavier. To the extent that plaintiffs face greater obstacles to recovery, they have less incentive to sue.

Thirdly, as the Georgetown Study indicates, a not insignificant portion of purported antitrust claims filed in the 1973-83 period amounted to little more than contract or tort disputes, which, for strategic purposes, were masquerading as treble damages actions. Litigants today are less inclined to employ this strategy, particularly in light of the increased willingness of courts to invoke sanctions for prosecuting frivolous claims pursuant to amended Rule 11 of the Federal Rules of Civil Procedure, which became effective on August 1, 1983. See Eastway Construction Corp. v. City of New York, 762 F.2d 243 (2d Cir. 1985). Reduction of these types of insubstantial claims is a benefit, not a loss, to the system.

Finally, the recent decision in Matsushita Electric Products Co. v. Zenith Radio Corp., 106 S. Ct. 1348 (1986), may further discourage antitrust suits by establishing a standard for summary judgment more hospitable to defendants in antitrust actions.

I do not think that empowering state attorneys general to sue on behalf of indirect purchasers will serve to reverse the present downward cycle in antitrust enforcement. On the contrary, this approach may make private enforcement actions even more difficult. In short, the proposed prescription is unlikely to cure the ill.

Finally, this bill would do more than reverse Illinois Brick in parens patriae cases. This measure, as I understand it, would also overrule the Beef cases by permitting sellers of agricultural products to interpose antitrust claims based on indirect sales. This goes beyond the scope of Hart-Scott-Rodino which was designed to protect natural persons and not corporate consumers. Many agricultural sellers are corporations and therefore neither natural persons nor consumers. This proposed extension of Hart-Scott-Rodino is both unwise and unwarranted.

CONCLUSION

The proposed legislation is unwise and is likely to impose burdens on the judicial system that will far outweigh any benefits.

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June 11, 1986

Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Dirksen Building
Washington, D.C. 20510

Re: S. 2481

Dear Senator Thurmond:

Your Committee has asked me to respond to the following question in connection with its deliberations on S. 2481:

> Will a legislative change to the Illinois Brick decision necessitate change of the Hanover Shoe doctrine as well?

In my view, Congress cannot overrule Illinois Brick without also overruling Hanover Shoe. These two cases are mirror images of each other. In Hanover Shoe, the Supreme Court held that the first purchaser from an antitrust violator is deemed "injured" within the meaning of Section 4 of the Clayton Act, 15 U.S.C. § 15, by the full amount of any overcharge and that the defendant may not escape treble damage liability by proving that the plaintiff passed on some or all of any overcharges to its customers. By lodging recovery in the hands of first purchasers, Hanover Shoe assures that there will always be a plaintiff or plaintiffs who can recover thrice the amount of any overcharges imposed by an antitrust defendant. Hanover Shoe thus promotes the deterrent function of antitrust enforcement.

The issue in Illinois Brick was whether plaintiffs who had not purchased directly from price-fixers but who claimed that overcharges imposed by defendants had been passed on to them through the chain of distribution were "injured" within the meaning of the Clayton Act. Whereas Hanover Shoe asked whether passing-on could be used as a defense, Illinois Brick asked whether passing-on could be used by plaintiffs offensively as a basis of recovery. The Supreme Court in Illinois Brick recognized that its ruling must treat the offensive and defensive uses of passing on equally:

> We are left, then, with two alternatives -- either we must overrule Hanover Shoe (or at least narrowly confine it to its facts), or we must preclude respondents from seeking to recover on their pass-on theory. [Illinois Brick Co. v. Illinois, 431 U.S. 720, 736 (1977).]

Reaffirming the principles enunciated in Hanover Shoe, the Court held that indirect purchasers may not prove that overcharges had been passed on to them and hence denied recovery. The court's rationale was three-fold.

1. Multiple Liability and Inconsistent Judgments

To permit offensive but not defensive passing on would create a serious risk of multiple liability. Under Hanover Shoe, first purchasers are entitled to full recovery, i.e., not subject to the passing on defense. If indirect purchasers were also permitted to sue, defendants might have to pay twice -- first 100% of the overcharge to direct purchasers as required by Hanover Shoe and second some or all of the very same overcharges which indirect purchasers might show had been passed on to them.

Moreover, unequal application of the passing-on doctrine would create a serious risk of inconsistent judgments. It is possible, for example, that direct purchasers in one action could sue and lose. Subsequently, indirect purchasers could sue the same defendants on the same alleged overcharges and win. In this example, indirect purchasers, not having been parties to the first judgment would not be bound by it. While requiring consolidation of all claims of direct and indirect purchasers might seem to provide a solution to this problem, the Supreme Court concluded that this approach would prove unworkable.

> But allowing indirect purchasers to recover using pass-on theories, even under the optimistic assumption that joinder of potential plaintiffs will deal satisfactorily with problems of multiple litigation and liability, would transform treble-damages actions into massive multiparty litigations involving many levels of distribution and including large classes of ultimate consumers remote from the defendant....The Court's concern in Hanover Shoe to avoid weighing down treble-damages actions with the "massive evidence and complicated theories," 392 U.S., at 493, involved in attempting to establish a pass-on defense against a direct purchaser applies a fortiori to the attempt to trace the effect of the overcharge through each step in the distribution chain from the direct purchaser to the ultimate consumer. We are no more inclined than we were in Hanover Shoe to ignore the burdens that such an attempt would impose on the effective enforcement of the antitrust laws. [Illinois Brick, at 740-41.]

2. Complexity

The uncertainties and difficulties in analyzing price/output decisions in the real world rather than in an economist's hypothetical model recognized by the Court in Hanover Shoe in the context of defensive passing-on are present with equal force where offensive passing-on is involved. The Court noted:

> However "long and complicated" the proceedings would be when defendants sought to prove pass-on...they would be equally so when the same evidence was introduced by plaintiffs. [Illinois Brick, at 732.]

3. Impairment of Treble Damages Remedy

The introduction of complex tracing problems into antitrust litigation would, the Court feared, reduce the effectiveness of treble damages actions as a tool for enforcing the antitrust laws. Indirect purchasers, with a comparatively small monetary interest in the litigation, have far less incentive to sue than the direct purchasers who are not only spared the burden of tracing overcharges but also permitted to recover the full amount of any overcharge under Hanover Shoe. Illinois Brick, at 745-46.

In my view, the Supreme Court in Illinois Brick correctly analyzed the passing-on issue and its holding strikes a proper balance between the principal goals of the private antitrust remedy: compensation and deterrence. The present bill, by overruling Hanover Shoe as well as Illinois Brick appears to recognize the logic of the Supreme Court in Illinois Brick. Nevertheless, it seems to me that the proponents of S. 2481 in extolling the virtues of overruling Illinois Brick, have not given sufficient attention to the likely adverse consequences of reversing Hanover Shoe. Were Congress to reverse Hanover Shoe, even in the ostensibly limited case posed under S. 2481, defendants will raise the passing-on defense at every opportunity. Direct purchasers, whose damages claims are not burdened by the necessity of tracing overcharges, would have little incentive to sue if their recoveries could be reduced -- possibly to nothing -- by competing indirect purchaser claims. Even if direct purchasers were to persevere and sue, the focus of the trial would shift from plaintiff against defendant to plaintiff-direct purchaser against plaintiff-indirect purchaser and create the very diffusion of benefits and decreasing incentives identified in Illinois Brick. Hanover Shoe is a strongly pro-plaintiff and pro-enforcement decision. To sacrifice this rule of law so that indirect purchasers might have the right to assert claims that are surely diffuse, often speculative and ultimately unprovable in a court of law as opposed to an economist's hypothetical model, is simply too high a price to pay.

In sum, the holding in Illinois Brick cannot be reversed without also overturning the decision in Hanover Shoe. However, the detrimental effects on effective antitrust enforcement which would be inevitably incurred far outweigh any benefits which would be derived from permitting indirect purchaser suits.

I appreciate the opportunity to respond to this question and would be pleased to respond to any additional questions.

Sincerely,

Edward D Cavanagh

Edward D. Cavanagh
Professor of Law

EDC:mc

The CHAIRMAN. I just have a few questions here.

Mr. Halverson, as I recall, plaintiffs' antitrust attorneys have opposed changing the *Illinois Brick* rule, is that right?

Mr. HALVERSON. Did you say some antitrust attorneys have opposed changing the *Illinois Brick*——

The CHAIRMAN. I understand that plaintiffs' antitrust lawyers have opposed changing the *Illinois Brick* rule.

Mr. HALVERSON. Well, I would like to defer to Ms. Wood, who does more plaintiffs' work, and let her answer that question.

The CHAIRMAN. All right, let her answer it.

Ms. WOOD. Mr. Chairman, I do represent antitrust plaintiffs with some frequency, and I would also like to point out that Steve Susman, a well-known plaintiffs' attorney, did concur in the ABA report that was filed the last time hearings were held in the Senate on *Illinois Brick*.

One point that has not been made that I might make is that it is quite difficult, I think, to assume, as the sponsors of this bill do, that compensation will ever reach the consumer under this bill.

It is very hard to find the consumer who bought the brick or the milk, or whatever product is the subject of the price-fixing conspiracy. We have examples of this in our report which I think make the point very effectively.

The CHAIRMAN. Is not their opposition based on their belief that the *Illinois Brick* decision has helped antitrust enforcement by reducing the ability of defendants to complicate cases?

Ms. WOOD. That may well be the case, Mr. Chairman. Their support of our report is probably based on a number of factors, of which that would be one.

The CHAIRMAN. Judge Renfrew, is there any reason to believe that changing the *Illinois Brick* rule only for the attorneys general will avoid the problems of tracing and the complicated proof of damages that led the Court to decide *Illinois Brick* as it did?

Judge RENFREW. No, I do not think so at all. I think every direct purchaser case where there is an ultimate consumer at a different level of distribution could potentially involve a parens patriae case and would have the same problems of proof and the same difficulties that Mr. Justice White talked about in *Hanover Shoe*.

The CHAIRMAN. Professor Cavanagh, this bill contains provisions for consolidating lawsuits in an attempt to avoid duplicative recovery against defendants. In *Illinois Brick*, did the Supreme Court consider joinder, but decide that suits by indirect purchasers would still become unmanageable?

Mr. CAVANAGH. They did, Senator. In the judicial code there are some provisions that could permit joinder, and the Court in *Illinois Brick* said that even if you could get all these people in by using these mechanisms that it would still make the cases inordinantly complicated.

I might add also, Senator, that it seems to me that these provisions, while they are well-intentioned, may not do the job that they were designed to do. It is conceivable, at least, that a case could be brought and settled very quickly before the joinder mechanism here actually had an opportunity to take effect, and then subsequently an indirect purchaser suit might be litigated and the defendant may end up paying twice, once by settlement and once by judgment, or simply twice through settlement.

The CHAIRMAN. Judge Renfrew, in the *Illinois Brick* decision, the Court considered whether each and every person who may have absorbed some indirect overcharge should be compensated.

The Court decided that it was less important to enable each and every potentially injured party to sue than it was to preserve deterrence and avoid overcomplication of antitrust suits.

In your view, was the Supreme Court's tradeoff correct?

Mr. RENFREW. Yes.

The CHAIRMAN. Would you want to elaborate any on that? [Laughter.]

Mr. RENFREW. Surely. I think if we assume that a violation is going to be detected and that there are direct purchasers and indirect purchasers, the issue that really separates people is if that remedy lies exclusively with direct purchasers, is that going to provide greater deterrence with treble damage actions than if we permit the indirect purchasers to sue and try and obtain compensation.

That is the issue that separates people who are for this legislation and those who oppose it. Based on my experience as a trial lawyer and as a trial judge and with the Department of Justice, I believe you will get greater deterrent effect by placing the remedy with the direct purchaser, who will have greater incentive because of the ruling in *Illinois Brick* to bring such suits, and they will have greater likelihood of recovery and the amount will be greater.

I think that brings a surer and swifter remedy, and in my judgment that is greater deterrence.

The CHAIRMAN. Judge Renfrew, you have had a lot of experience as a trial judge and as a practicing attorney and in the Justice Department during the Carter administration, I believe, as deputy attorney general.

Do you really feel that what you are saying here is the correct course for the public?

Mr. RENFREW. Let me tell you, in my district when I sat on the Northern District of California, we had two treble damage actions, private actions that led to cases of tremendous significance.

The first was a private treble damage action involving the gypsum wallboard industry, and that led to a grand jury indictment and, ultimately, the Supreme Court decision in *United States* v. *United States Gypsum*.

The second was a private treble damage action involving the paper label industry. That led to a grand jury investigation and the paper label cases. That grand jury investigation led to a whole myriad of cases in the forest product industry—folding carton, corrugated, et cetera—perhaps the most extensive series of Government and treble damage actions in the history of antitrust enforcement. They came from private antitrust enforcement.

The thing that separates us is how are we best going to preserve the private antitrust enforcement action. I feel it will be impaired if you set aside the ruling in *Illinois Brick*. Senator Metzenbaum feels that it would be supported, and I guess this is our difference and I think we have an honest difference of opinion here.

Senator METZENBAUM. Judge Renfrew, I would totally defend your right to be wrong. [Laughter.]

Mr. RENFREW. Thank you, Senator.

The CHAIRMAN. I presume you would feel the same way about the Senator.

Mr. RENFREW. Oh, surely. [Laughter.]

Senator METZENBAUM. He does not need any help, Mr. Chairman.

The CHAIRMAN. He is very articulate.

Mr. Halverson, you have had a lot of experience as a practicing attorney.

Mr. HALVERSON. Yes, I have.

The CHAIRMAN. You were Chief of the Antitrust Division, I believe, in the FTC, were you not?

Mr. HALVERSON. That is right, for 3 years.

The CHAIRMAN. Now, do you really feel that the course here is best for the public, as outlined in the *Illinois* Brick case?

Mr. HALVERSON. Yes, I do, and I believe the language of *Illinois Brick* which is cited in my statement is as true with respect to the proposal here as it was when *Illinois Brick* was decided. I agree.

The CHAIRMAN. Mr. Cavanagh, you are professor of law. Do you have any ties to any corporation or anybody to influence your opinion?

Mr. CAVANAGH. No, Senator.

The CHAIRMAN. Do you feel that what you say here is in the best interests of the public?

Mr. CAVANAGH. Absolutely, Senator.

The CHAIRMAN. Why do you feel that way?

Mr. CAVANAGH. Well, I can only reiterate what Judge Renfrew and Mr. Halverson and Ms. Wood have said before. It seems to me that with the rule of *Illinois Brick,* we concentrate recovery in the hands of one group of people, the direct purchasers.

They do not have to worry about tracing overcharges in recreating the price output decisions that you would have to do if you permitted indirect purchaser suits. It seems to me that as long as you have that one group of purchasers there threatening price fixers with treble damage recovery, that is a stronger deterrent than we would have if we diffused benefits by permitting indirect purchaser suits.

The CHAIRMAN. Ms. Wood, you are a member of a big law firm in New York, are you not?

Ms. WOOD. I am; yes, I am, Mr. Chairman.

The CHAIRMAN. Do you represent plaintiffs and defendants in that firm?

Ms. WOOD. We do, yes.

The CHAIRMAN. Do you feel that the position you are taking here is in the best interests of the public at large?

Ms. WOOD. I do, Mr. Chairman, for the reasons that have been cited by the panelists here.

The CHAIRMAN. I think that is all the questions I have. I will now turn you over to the able and distinguished Senator from Ohio, an expert on antitrust matters. [Laughter.]

Senator METZENBAUM. Oh, yes; oh, yes; oh, my, yes.

Professor Cavanagh, you had made a point in your testimony that this administration has been less than enthusiastic about enforcing the antitrust laws. Did I understand you correctly?

Mr. CAVANAGH. Well, what I said, Senator, was that I thought that in terms of their case selection and where they have devoted their resources, they have devoted them to specific kind of cases, the bid-rigging case and Government procurement contracts, a very narrow range of cases which have been giving rise to criminal indictments.

Those kinds of cases rarely give rise to private follow-on litigation, and I think that is an explanation for why we have the declining statistics. They also have not done a whole lot of enforcement. I think it is clear from the record that they have not been enforcing the vertical price-fixing cases, as Congress has recognized.

I do not think that this administration has brought one vertical price-fixing case. But I think the Antitrust Division has limited resources. What they have done—their case selection has basically been in this one area, which does not give rise to follow-on litigation.

Senator METZENBAUM. Other than the bid-rigging cases that you said they have gone forward on, they have done very little as far as mergers are concerned; done very little about price maintenance and that kind of thing.

In fact, they tried to go into the Supreme Court on the side of the price fixer.

Mr. CAVANAGH. In the *Monsanto* case, I think.

Senator METZENBAUM. That is right.

Mr. CAVANAGH. Before you stopped them.

Senator METZENBAUM. Before we stopped them; that is right.

I would remind the chairman that Congress stopped the administration from going into the Supreme Court with an amicus brief in support of price fixers.

Now, under those circumstances, how do you account for the fact that millions of Americans buy automobiles—and assume that General Motors and Ford and Chrysler told their dealers what the minimum price was that a car could be sold at, or, as the woman who testified in behalf of the consumer groups said, assume that the drug manufacturers told all of the druggists the minimum prices at which their products could be sold.

Assume something that I know would not happen, that a company like Chevron told all of its dealers the minimum price at which they could sell gasoline or they would lose their right to buy Chevron gasoline, or possibly the leasehold. Assume all of that.

How would you see to it that the consumer would be protected in any of those three cases?

Mr. CAVANAGH. Well, Senator, I am confident in that circumstance that the people——

Senator METZENBAUM. I am sorry?

Mr. CAVANAGH. I am confident, in the circumstances you describe, that the people in the first instance would sue. The automobile retailers, the pharmaceutical retailers, and the other case that you mentioned, the petroleum retailers, would sue.

Senator, when I was in practice, I worked on the tetracycline cases.

Senator METZENBAUM. On the what?

Mr. CAVANAGH. The tetracycline cases, and in that case a number of drug retailers did, in fact, sue the manufacturers. So I am confident that in those circumstances there would be lawsuits.

I would also hope that the Congress could bring sufficient pressure through the oversight process, through resolutions, and so forth, and through the budgetary funding process—sufficient pressure on the Antitrust Division to bring those kinds of suits if you have got a case that is a clear vertical price-fixing case in the automobile——

Senator METZENBAUM. We cannot even get the Justice Department to prosecute white collar criminals. If they have white collars, they do not care whether they have killed people or not insofar as the pharmaceutical industry is concerned. So I do not think we are in any position to do that.

Now, let us go back to this question that you are quite confident that they would sue. You know the automobile industry, I assume, somewhat. An automobile dealer owes his very existence to his ability to get along with the manufacturer, with the distributor.

He needs to get a car that is made in a certain way. He needs delivery promptly. Sometimes he does floor financing of his automobiles. He needs to maintain a good relationship. If that dealer had the audacity and the courage to sue the manufacturer, do you really think he would be willing to do it?

Mr. CAVANAGH. Well, lawsuits are never pleasant things, Senator. I mean, it is hard to want to sue your source of supply.

Senator METZENBAUM. But why not let the customer who is getting shafted—why not let that person sue instead of saying we are going to count upon the dealer? Have there been any dealers who have sued? Do you know of any?

Mr. CAVANAGH. Well, I do not know that we have had a major problem with automobile price-fixing as of late. But I think if you let the consumer sue, then you just create all the problems that we have discussed about diffusing.

Senator METZENBAUM. All the problems are complexity; all the problems are that it may increase the cost. All the problems are it will increase the benefits of the treble damage remedy. That is Judge Renfrew's testimony.

But I am saying to you, what is so terrible about complexity? Do you deny somebody a remedy? We are talking about people who have violated the law, ostensibly. If they have not, of course, there is a total defense.

But if they have violated the law, we are saying why should you deny the individual that individual right?

Mr. CAVANAGH. One point I want to make, Senator, in your question. If you had a situation where the retailers and the manufacturers of the cars were conspiring together, there is no question there that the consumer could sue.

Senator METZENBAUM. I did not say that.

Mr. CAVANAGH. No.

Senator METZENBAUM. I did not say they were conspiring. There is no conspiracy. Let us assume the manufacturer said the minimum price at which you can sell a Taurus or a Sable, which happen to be hot cars at the moment, is $600 over your cost and we do not want you to sell them at anything less than that.

That would not be any conspiracy; that would just be an order. Let us assume that the manufacturers agree in the beer industry—as you know, we have pending legislation on that—that they agree to protect the marketplace of each other; they agree that the prices will not be cut.

Does it not bother you that nobody has a remedy?

Mr. CAVANAGH. Well, I think the retailers have the remedy, and if the retailers are going along with the manufacturers, then it seems to me that there is a conspiracy.

Senator METZENBAUM. The retailer does not care. The retailer is pretty satisfied. Let us assume the case that I gave you where the automobile dealer is going to make at least $600 over issue, over his cost, plus the rebate that he gets. So he is very happy about it. He does not want to sue. He says, right on; that is the greatest thing since apple pie.

Mr. CAVANAGH. Well, he may very well be hurt over time with his volume of sales. I do not think it is fair to say, Senator, that just because one could conceivably pass along an overcharge that you are not hurt, because as your price goes up, your customers may decide to go and buy Toyotas and Datsuns rather than Sables or other kinds of Ford cars.

Senator METZENBAUM. Ms. Wood, I did not quite get this whole argument about whether the plaintiffs' lawyers like it or do not like it. I have not heard any concern about plaintiffs' lawyers in the last several years on antitrust issues, although they try to be heard.

All of a sudden, we are saying that Mr. Susman has said it is OK and therefore it is OK.

Ms. WOOD. No.

Senator METZENBAUM. Well, I do not know if I caused the chairman to sneeze on that point or not. [Laughter.]

But I do not understand where any——

The CHAIRMAN. A natural response. [Laughter.]

Senator METZENBAUM. Whether the plaintiffs' lawyers think it is good or bad may relate directly to their economic interests. I am interested not in their economic interests; I am interested in the viability of the free enterprise system, free competition working and the people having the right to do something about it when it does not work.

That is what this whole issue is about, and that is the reason each of you, with the exception of the professor—the reason I feel each of you is here, because you do not want free, competitive forces to work, and when they do not work you do not want anybody to have a right to do anything about it.

You say, Judge Renfrew, that it is complex and it might cut down on deterrence. We have already heard from Mr. Halverson—in his report, he points out that from the standpoint of cases filed, there have been as many filed before as there have after the *Illinois Brick* decision—77 percent and 78 percent. So I do not think from the deterrence standpoint that it has made much difference.

Mr. RENFREW. Well, let me say, Senator, I think everybody agrees there are three purposes to be served by a treble damage action. One is to punish the violator. Two is to deter future violations, and the third is to compensate the victim.

What we are doing is taking a look at those three purposes and trying to determine how they are best served. You may emphasize one more than the other, and the history of democracy is the history of making effective compromise between often competing interests.

What we are trying to do is forge an antitrust enforcement remedy that meets those three purposes and that best serves the public. We disagree as to whether there is an impact on the deterrent effect or not, but that does not mean that the presentations we are making are biased because of representation.

That simply is the reason why it was mentioned about Mr. Susman. You suggested that you kept your tongue in your cheek when I testified and Mr. Halverson testified because we had represented defendants, as I did in my private practice, and I work for a large corporation.

Mr. Susman's name was brought up because Mr. Susman has successfully represented plaintiffs in some of the most important and largest antitrust treble damage cases in this country.

That is simply to show that people with different perspectives in antitrust law have reached the same conclusion with respect to the impact on the deterrent effect.

Senator **METZENBAUM**. But the people here who have a right to speak for consumers—every one of them says "pass this bill." The Consumers Federation of America and all the consumer groups and the farmer groups want this bill.

So, what I am saying is that quite often I identify with the position of the plaintiffs' attorneys. In this instance, I say what difference does it make what they want. I am concerned about whether or not we are going to provide a remedy for the individual consumer.

I am saying, and I think quite properly, that I do not think that the spokesperson for Chevron or the spokesperson for defendants in antitrust cases is in a proper position to state what is best for the consumers.

I think that there is a reason for me to look askance at that concern of yours and say, is that for real; have they ever indicated any real consumer concern before.

Mr. **RENFREW**. I would hope that my arguments would be judged on the basis of their logic and their rationality and the experience upon which they are drawn rather than on my present occupation.

You talk about consumers. I think that consumers should be the basis of all antitrust enforcement, of course; there is no question about it. But the question is, are the consumers best served by this legislation.

Take the case, for example, of Levi Strauss, the manufacturer of denim jeans, which was charged with some violation of the antitrust laws, and it was settled on the basis of some 20- or 30-cents-per-pants overcharge.

Did the consumers actually benefit from that particular remedy? Very few people actually applied to obtain the 20- or 30-cents-per-pants. The parens patriae statute contemplated that the consumer would not apply and that the damages would be in the form of a civil penalty—that is section 4(e)—and that the damages would be used to benefit the interest of the class of injured consumers or for some public purpose.

Now, there may be some deterrence there. My perception is that you would get a greater antitrust deterrence if the people directly in the purchase chain were the ones that got the total recovery.

They would have a greater incentive to sue. They would know before whether there had been a violation or not and would sue

Senator METZENBAUM. But you do not seem to be concerned about the reality and the problem of many who are the middle persons between the consumer and the manufacturer—the reality and problem of that individual suing.

Mr. RENFREW. That is the problem we have because, as you mentioned, of the many people between the manufacturer and the consumer—everyone in that line of distribution is going to be involved in that litigation.

You are going to have to show the impact of the overcharge on each one of those levels of distribution, and that makes it a very difficult thing to try.

Senator METZENBAUM. That is the plaintiff's problem, not the defendant's.

Mr. RENFREW. No, it is not just the plaintiff's problem. They have to prove their case in a court of law, and if their case is simply not manageable—if each one of those transactions involves individual facts and circumstances, this may undercut the manageability of a class action and you may lose a great deterrent benefiting the very class you are seeking to protect.

Senator METZENBAUM. So because it may be complex and difficult to manage, you would just deny the individual the right. That is what you saying; that is the bottom line.

Mr. RENFREW. My bottom line is I think that the antitrust enforcement is best served by putting the maximum incentive on the person immediately impacted by the violation, and that is the direct purchaser.

Senator METZENBAUM. Well, we started off in disagreement and I guess we finish in disagreement.

The CHAIRMAN. Well, you all disagree. I think we had better move ahead.

Senator METZENBAUM. I have no further questions, Mr. Chairman.

The CHAIRMAN. I do not want to rush you.

Senator METZENBAUM. No; I am perfectly satisfied, and when push comes to shove, nobody has convinced anybody. But it has been interesting to have this dialog. I was particularly impressed with the professor's testimony because I felt that there was a great sense of balance in what he was saying. He was candid in indicating the failure of the administration to do much of a job in antitrust.

The CHAIRMAN. I thought you would be pleased with that. [Laughter.]

Senator METZENBAUM. Yes; I just wanted to keep repeating it, Mr. Chairman, in case you were not paying attention the first or second time I said it.

The CHAIRMAN. I have always got an ear open.

Senator METZENBAUM. You certainly do, Mr. Chairman, and I want to thank you for holding this hearing, which was done at my request. You have always been very gracious to me and I appreciate the opportunity.

The CHAIRMAN. It is a pleasure to do it, Senator. I am always glad to accommodate such an able and distinguished antitrust lawyer.

Senator METZENBAUM. Thank you very much, and if we have nine votes when the bill is up in committee, it will be just great.

The CHAIRMAN. We now stand adjourned.

[Whereupon, at 11:51 a.m., the committee was adjourned.]

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